2004

Report of the
Auditor General of Canada
to the House of Commons

NOVEMBER

Matters of Special Importance—2004
Main Points

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Auditor General of Canada
Vérificatrice générale du Canada

To the Honourable Speaker of the House of Commons:

I have the honour to transmit herewith my annual Report of 2004 to the House of Commons, which is to be laid before the House in accordance with the provisions of subsection 7(3) of the *Auditor General Act*.

Sheila Fraser

Sheila Fraser, FCA
Auditor General of Canada

OTTAWA, 23 November 2004

Matters of Special Importance—2004

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Sheila Fraser, FCA
Auditor General of Canada

Introduction

1. This is my fourth annual report to the House of Commons. As I approach the midpoint of my term as Auditor General, I look back with pride at the accomplishments of my Office and I look forward to our future challenges. In particular, I appreciate the devotion to duty my staff has shown during what has been a year of intensive work.

2. I am deeply touched by Canadians' continued response to our work over the past year. Their messages have reinforced my belief that Canadians expect their government to manage its programs and services well; give them value for their tax dollars; and be honest, forthcoming, and accountable for its actions.

3. Typically, my annual chapter on matters of special importance highlights the work of my Office over the previous year. However, with the increased attention being given to governance issues and the start of a new Parliament, I would like to suggest some issues, based on my perspective as Parliament's auditor, that members of Parliament may want to consider:

- the need to clarify the accountabilities of ministers and senior public servants;
- the need for greater parliamentary scrutiny of government spending to ensure that the government is accountable for its operations; and
- the need to follow closely the government's ambitious efforts to transform and strengthen public sector management, including monitoring these efforts to ensure that changes are fully implemented.

4. In this chapter I would also like to explain briefly the role of the Office of the Auditor General as the auditor for Parliament.

Working together: Parliament, the government, and the public service

5. The past year marked a period of substantial change: the recent federal election; the reorganization of the federal government, which started a year ago; and the introduction of measures to strengthen management in the public service. Underlying these changes is the need for Parliament, the government, and the public service to work together in ways that serve Canadians well. While each is without doubt committed to working for the common good of the country, to truly achieve this objective all three must work together constructively—each fulfilling its own responsibilities and respecting the roles of the others.

Parliament holds government accountable to Canadians

6. Parliament is one of our deepest and most fundamental expressions of democracy, an institution that helps to define our nation and its character. In addition to passing laws, one of Parliament's primary duties is to maintain responsible government by holding the Prime Minister and Cabinet accountable to it and, ultimately, to Canadians. Canadians elect their members of Parliament to play this crucial role, with a mandate to speak and act on their behalf.

7. Parliamentarians work hard to fulfill the many responsibilities they assume. Theirs is a difficult job: holding public office requires a high level of personal and professional sacrifice—something that veteran members of Parliament will no doubt tell their colleagues in the 38th Parliament who are sitting in the House for the first time. As well as acting on behalf of their own constituents, they work for all Canadians through their activities related to passing legislation and their oversight of government.

The government of the day provides the public service with direction

8. The government of the day puts forward a policy and management agenda to serve the diverse needs and interests of Canadians, and it reports back to Parliament on its actions and accomplishments. The government proposes new laws in Parliament, and its ministers give the public service the direction it needs to deliver programs and policies. In turn, the public service supports the government and ministers by providing professional, non-partisan advice, and it serves Canadians by delivering programs under present laws and policies.

9. Parliament, the government, and the public service each have key roles and responsibilities in the parliamentary system. While there may be natural tensions between them, only by working together can they achieve the desired results for Canadians. One issue of particular concern to me, one I have mentioned in previous reports, is the need for accountabilities of ministers and senior public servants to be clear and to be respected.

Accountabilities of ministers and senior public servants need to be clarified

10. On the surface, the accountabilities and responsibilities of ministers and senior public servants are unambiguous. Canadians elect the government, and it is to be held to account in Parliament for the way it uses public authority. Ministers are individually accountable to Parliament for their own actions and for all aspects of their departments' and agencies' activities. Deputy ministers and public servants are accountable to ministers, not to Parliament directly.

Accountability—The obligation to render an account of, and accept responsibility for, one's actions, both . . . the results obtained and the means used.

Report of the Auditor General of Canada, Chapter 7, March 2004

Responsibility—Identifies the field within which a public office holder (whether elected or unelected) can act; it is defined by the specific authority given to an office holder (by law or delegation).

Guidance for Deputy Ministers, 2003

11. These key aspects of accountability in Canada rest on traditional principles of Westminster-style government, but they are applied in an environment quite different from the one that existed when they were established in the 18th century. Increasingly, questions have arisen about whether these principles are still appropriate in today's environment, whether they are well-defined, and whether they are observed consistently.

12. Calls to clarify accountability have come from many directions. Canadians are demanding greater accountability for the way the government spends their tax dollars and uses its authority. Academics question the relevance of stated tenets of accountability in today's complex and rapidly changing environment. Public institutions and parliamentary committees debate the concept, search for more definition, and seek alternatives.

13. My Office has a long-standing interest in accountability. Many of our audits have examined it in practice, and we have urged that action be taken to ensure that it is respected, to clarify it where necessary, and to translate those clarifications into consistent practice. It is clear by now that accountability is an important contributor to good governance. Events have shown that it is time to clarify the principle and how it will be practised.

14. One concrete example that needs to be addressed is that senior public servants are sometimes asked at parliamentary committee hearings to defend policies promulgated by their ministers. Ministers, who in fact are accountable for policy issues, do not always attend committee hearings. This points to the need for clarifying and respecting the roles and responsibilities of senior public servants when they appear before committees. Committees may want to consider developing formal guidance that would set the parameters for the types of questions that committee members may ask of senior public servants. At the same time, committees may also want to set out their expectations of ministers when they do appear before them to discuss legislation or the Estimates.

15. The government recently issued several documents to explain accountability and responsibility, including its Guide for Ministers and Secretaries of State; Guidance for Deputy Ministers; the Management Accountability Framework; and the Values and Ethics Code for the Public Service. I have expressed concern in previous audits about the clarity of the documents and have recommended that the government describe more fully how it intends to turn into action the principles they set out.

16. In its current efforts to transform and strengthen public sector management, the government has recognized that the accountabilities and responsibilities of ministers and senior public servants need to be defined more completely. Earlier this year, it undertook a review to determine whether the doctrine of ministerial responsibility and accountability is fully understood and whether it needs to be adjusted. This represents an important step, as there are significant issues related to this concept that warrant further study and explanation.

Parliamentarians' attention may help the government clarify roles and responsibilities

17. I believe that the clarification of the government's existing accountability documents and its current review of the issue offer an opportunity to examine the appropriateness and effectiveness of ways of holding ministers and senior public servants to account for their decisions and performance. It has been argued that another dimension that needs to be added to this discussion could be termed "duty"—the obligation of all participants to act in the public interest—a concept that transcends legal responsibility. I would agree that this is an important dimension of the discussion.

18. Parliamentary opportunities to debate these fundamental issues do not come along every day; I would encourage members of Parliament to give particular attention to these issues when they are brought before them. Indeed, parliamentarians have an essential role to play in this process, as they may be in the best position to facilitate the next step by encouraging the government to move quickly to resolve these issues.

Greater parliamentary scrutiny of government spending will aid accountability

19. Parliament authorizes both the government's raising of revenues and its expenditures. One important aspect of parliamentarians' work is their role in ensuring, through their review of the government's spending and revenue plans and its performance reports, that the government is accountable for its operations.

The Estimates process provides parliamentarians with an opportunity to challenge the government's plans and review the results

20. Parliamentarians scrutinize the performance expectations set out in the government's plans and priorities documents, and they review its subsequent reports on actual performance. Each spring, the government's Main Estimates set out its planned spending and expected results in the reports on plans and priorities tabled for each department and agency (including plans for the use of human resources, assets, tax expenditures, and revenues). Each fall, departmental performance reports by each department and agency outline the results achieved in relation to the plans.

21. These Estimates documents are fundamental to an effective accountability relationship between Parliament and the government. Standing committees of the House of Commons are the primary vehicle for parliamentarians' review of the Estimates documents. Recent changes, such as the creation of the Standing Committee on Government Operations and Estimates in 2002, are intended to improve the Estimates review process.

22. However, as several of our past audits have shown, the government needs to improve the Estimates documents. Their close review by Parliament could serve to help strengthen them. The government needs to be clear and specific about its plans in order to allow for thorough parliamentary review and challenge of the Estimates. In turn, parliamentarians' more in-depth analysis of departments' and agencies' performance reports closes the accountability loop by holding the government to account for its performance against its plans. Parliamentarians may wish to consider in more detail the linkages among the Government Expenditure Plan, the Main Estimates, reports on plans and priorities, and departmental performance reports.

23. I was pleased to note in this year's Budget speech that special examinations of Crown corporations (a form of performance audit) that are conducted by my Office are to be tabled in Parliament and posted on the corporations' Web sites. Closer parliamentary scrutiny of Crown corporations through the review of special examinations and other Crown corporation documents that are tabled in the House—corporate plan summaries, capital and operating budget summaries, and annual reports—may improve the accountability of these public institutions.

Current efforts to change government need to be managed carefully

The government has launched an ambitious management reform agenda

24. Beginning 12 December 2003 and continuing into 2004, the government made a series of announcements as part of the Strengthening Public Sector Management initiative. It announced a fundamental review of all programs and expenditures to ensure that spending remains under control and closely aligned with the evolving priorities of government. This includes identifying significant savings to the government through reviews of departments, assessing the adequacy of management of horizontal policies and programs, and identifying opportunities for improvements in government operations in areas such as capital asset management as well as procurement and contracting. It also involves reviews of the *Financial Administration Act*, accountabilities and responsibilities of ministers and senior public servants, and Crown corporations.

25. This is an ambitious initiative, a major addition to the government's existing policy and management agenda. Its implementation will doubtless require significant financial resources and commitments of time on the part of the public service. I would raise a note of caution as the government undertakes these reviews and considers actions to modernize its operations: the magnitude of change it is contemplating is considerable, and the public service may not have the capacity to conduct all of these reviews and make all of the changes in a short period of time. The government may wish to consider staggering the reviews and the implementation of changes arising from them.

Parliamentarians' involvement can encourage far-reaching changes

26. These efforts to transform and strengthen public sector management have the potential to lead to far-reaching changes; parliamentarians may wish to assume an active role in overseeing them. The involvement of members of Parliament can encourage the government to fully implement the needed changes. Parliamentarians could consider designating a standing committee responsible for monitoring the initiative's progress.

Our role as auditor for Parliament

27. The role of the Office of the Auditor General is to audit government operations and to provide the information that helps Parliament hold the government to account for its stewardship of public funds. Our responsibility is to Parliament. We assist Parliament in its work related to the authorization and oversight of government spending and operations. We attend hearings before a wide range of parliamentary committees to discuss in more detail our work on the issues they consider.

28. Indeed, the audit function—both internal audit and external audit—has a key role to play in government. The government's internal auditors provide senior government managers with the assurances they need that departmental systems and controls are working well. As the government's external auditor, my job is to give Parliament the information and assurance it needs to effectively hold the government to account for its use of public funds.

29. By their nature, audits often signal weaknesses, and in turn provide recommendations for addressing them. Where they are implemented, recommendations help to improve the government's management of programs and practices in departments and agencies. In some cases, however, audit reports—including our reports—can have unintended consequences.

30. One such consequence could be that in response to audit reports, the government might impose more rules and controls on government operations instead of considering other options to correct deficiencies. While management is always a balance between exercising flexibility and imposing control, adding more controls might not address identified problems. I have said that more controls are not necessarily the solution; existing controls should be made clear and meaningful and should be applied consistently.

31. It is important that departments have some flexibility to decide how they will deliver their programs and services. There has to be an environment in which departments and public servants can learn without fearing that mistakes will be viewed out of context. Public servants need to be supported by senior management as they work to implement the government's agenda, and have confidence in the support of their minister and deputy minister if problems should arise. Public servants need the space to do their jobs—and to take reasonable, well-considered risks and to be creative—or they will become risk-averse and their creativity will be stifled, to the detriment of Canadians. Innovation and continuous learning need to be fostered.

32. Indeed, in a large and complex organization like the federal government there are bound to be mistakes, despite the best efforts of those involved. While certain actions and behaviours should not be tolerated, mistakes can happen. Each situation needs to be evaluated in its own context.

Canadians are well served by their federal public service

33. Another unintended consequence of audit reports is that while they present findings on specific programs or issues, those findings are sometimes generalized as applying to the government as a whole. This could serve to diminish the trust Canadians have in government and the public service.

34. That would be unfortunate. Each day, thousands of public servants do significant and often unheralded work to improve the lives of millions of Canadians, many in the most vulnerable segments of society. This work ranges from processing Canada Pension Plan, Old Age Security, and Employment Insurance benefits to inspecting and ensuring the safety of our food supply, to working to preserve and enhance the quality of our natural environment, to serving in peace keeping operations. Public servants protect our sovereignty, our security, and our economic interests at home and abroad. I continue to be impressed by the professionalism, commitment, and resilience of public servants in their efforts to ensure that Canadians are well served by their government.

Conclusion

35. It has been said that trust in government is no longer a given; it must be earned. Indeed, Canadians are demanding more and deserve more from public sector leaders and institutions. To serve Canadians effectively, to maintain and, in some cases, regain their trust, the key players in our parliamentary system—Parliament, the government, and the public service—need to work together to ensure that roles and responsibilities are well understood and respected. Their relationship needs to work for Canadians.

Main Points

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Internal Audit in Departments and Agencies

Chapter 1

Main Points

1.1 We assessed the extent to which internal audit groups in six federal organizations had met professional standards and complied with the Treasury Board Policy on Internal Audit. We found that it varied considerably across these organizations.

- In two organizations (Public Works and Government Services Canada and the Royal Canadian Mounted Police), the internal audit group generally met the *International Standards for the Professional Practice of Internal Auditing*.
- Three departments partially met the standards (Foreign Affairs and International Trade, Human Resources Development Canada, and Natural Resources Canada).
- One agency did not meet many of the standards (Canadian International Development Agency).

1.2 Our work identified a number of important factors that, if implemented, could have a positive influence on the quality of internal audit across government:

- a consistent understanding on the part of senior management of the role that internal audit can and should play;
- a departmental audit committee with external members who are independent of management;
- a clear human resource strategy at the department, central agency, and government level that sets out the qualifications and appropriate number of staff for the internal audit community;
- a focus on assurance services; and
- a strategy to ensure appropriate internal audit coverage and capacity in small entities.

1.3 We found that the Treasury Board Secretariat has yet to establish and fund a strategy that will enable it to meet the requirements of the Policy on Internal Audit and the expectations of the internal audit community.

Background and other observations

1.4 Internal audit is an important element in enabling deputy heads to ensure that their departments have an effective internal control system. Internal auditors conduct risk-based audits and identify, where necessary, improvements in an organization's risk management strategy and practices, in its management control framework, and in the information systems it uses for decision making and reporting.

1.5 Effective 1 June 2004, the government re-established the Office of the Comptroller General to strengthen comptrollership and oversight across the federal government. The Comptroller General's key duties include setting or reviewing auditing standards and policies of the Government of Canada, providing leadership to ensure and enforce appropriate financial controls, and promoting sound resource stewardship at all levels across the federal government.

The Treasury Board Secretariat has responded. The Secretariat agrees that improvement is required. The government has directed the Secretariat to establish a more effective government internal audit function. As a result, the Comptroller General is currently developing proposals to ensure that the Canadian public service has a high performance internal audit regime. These proposals address many of our recommendations and are described following the conclusion.

Implementation of the National Initiative to Combat Money Laundering

Chapter 2

Main Points

2.1 To strengthen its anti-money-laundering strategy, in 2000 Canada introduced the National Initiative to Combat Money Laundering, making it mandatory to report certain financial transactions to the new Financial Transactions and Reports Analysis Centre, or FINTRAC. The mandate of FINTRAC was to analyze these transaction reports and disclose information to police and other authorities to facilitate the investigation and prosecution of money laundering. After September 11, 2001, FINTRAC's mandate was broadened to also apply to the financing of terrorist activities. Canada now has a comprehensive strategy against money laundering and terrorist financing that is generally consistent with international standards. However, a number of factors impede the strategy's performance.

2.2 Legislation limits the information FINTRAC may disclose on suspicious transactions to so-called "tombstone" data: account numbers; names of the account holders; and places, dates, and values of transactions that have occurred. When a disclosure is related to an ongoing investigation, these data can be useful in corroborating findings or providing new leads. Otherwise, law enforcement and security agencies normally find that the information FINTRAC discloses is too limited to warrant action, given their existing caseloads and scarce resources. In short, as the system now works, FINTRAC disclosures can contribute to existing investigations but rarely generate new ones.

2.3 Effective efforts against money-laundering and terrorist-financing activities begin where these activities take place—with the financial institutions and others that handle the illicit funds. FINTRAC has an extensive outreach program to help the parties who are required to report understand their obligations. However, it gives them little feedback on their reports and on trends in money laundering and terrorist financing, feedback that could help them identify suspect transactions and produce better reports. Moreover, policies and procedures to monitor and ensure their compliance with reporting requirements have still not been implemented fully.

2.4 The Initiative involves a partnership among several federal organizations, law enforcement and security agencies, and industry regulators. All of these partners need to work together closely if resources are to be used effectively to detect and deter money-laundering and terrorist-financing activities. We found that while the partners interact regularly, co-operation among them could be improved.

2.5 One area where improved co-operation would help is the development of effective accountability mechanisms for the Initiative. FINTRAC collects and analyzes huge quantities of reports and other information and provides financial intelligence to law enforcement agencies and other authorities. It depends on their feedback to know how they use its disclosures and to what benefit. To date, however, not all recipients track their use of the information disclosed to them by FINTRAC. Without a comprehensive system for monitoring the use of its disclosures, it is impossible for FINTRAC to assess the value of the intelligence it provides and how it can be made better. It is equally impossible to assess the Initiative's performance overall and its impact on money-laundering and terrorist-financing activities in Canada.

2.6 We identified a number of government actions needed to make the Initiative more effective:

- Broaden the kinds of information that FINTRAC may disclose, within limits that respect the privacy rights of Canadians.
- Implement a management framework to provide direction and to strengthen the co-ordination of efforts within the federal government and with stakeholders at other levels of government and in the private sector.
- Establish accountability structures to ensure that the information needed for measuring the Initiative's performance is collected and that results are reported to Parliament regularly.

2.7 Legislation calls for parliamentary review of the Initiative by 5 July 2005. The parliamentary committee conducting that review may wish to look at these issues and at whether lawyers are still exempt from the anti-money-laundering legislation, as they have been since March 2003 following successful legal challenges.

The government has responded. FINTRAC, the Department of Finance Canada, and the Canada Revenue Agency are in general agreement with our recommendations. Their respective responses are included in full throughout the chapter.

National Defence
Upgrading the CF-18 Fighter Aircraft

Chapter 3

Main Points

3.1 Fourteen years will have elapsed from the time National Defence identified the need to modernize the CF-18 until Phase 1 upgrades are completed on 80 of 119 fighter aircraft in 2006. Phase 2 concludes the modernization and is scheduled for completion in 2009, after which National Defence expects to fly the CF-18 until 2017 or longer. Delays in the approval processes, the budget cutbacks of the late 1990s, and the increasing cost of maintaining existing equipment have contributed to the length of time taken before the aircraft's deficiencies could be fixed.

3.2 In Phase 1, we found some problems with project and risk management, staff shortages, and approval delays. These concerns need to be addressed so that they do not become impediments to the successful completion of Phase 2. If they aren't addressed, the final delivery of fully upgraded CF-18s could be delayed beyond 2009. The current CF-18 airframe has a limited amount of flying hours left, so the Department needs to take full advantage of its investment in the modernization by ensuring upgrades are installed and available to pilots as soon as possible.

3.3 We looked at the largest-dollar contract for each of the five upgrades and found them to be within cost. We found that the work being done on the aircraft was addressing critical deficiencies and National Defence officials were satisfied that the aircraft being delivered at the time of our audit were meeting the Department's performance expectations.

3.4 When delays and staff shortages threatened certain testing milestones, operational and technical test staff at the Department worked together to overcome those problems and meet their deadlines.

3.5 Three of the five Phase 1 upgrades are proceeding on time; two are behind schedule. One, a flight simulator training system, was to be ready for pilot training by the time Phase 1 upgraded aircraft were delivered; instead, the system is delayed by up to two years. As a result, the Department will forgo savings expected by using the old training system until the new one arrives and may see increased fatigue on the aircraft due to added flying training hours.

3.6 In order for National Defence to get full advantage of the improved operational capabilities until 2017 or longer, it must ensure that it can address existing pilot shortages, shortages of air technicians who maintain the aircraft, shortages of spare parts to keep the aircraft flying, and budgetary pressures on operational funding. Until these concerns are resolved, National Defence cannot get assurance that the $2.6 billion investment in the CF-18 will enable it to meet operational demands until 2017 or longer.

Background and other observations

3.7 National Defence is modernizing 80 of its CF-18s to fix capability deficiencies that have existed since the early 1990s. The $2.6 billion multi-year, multi-project upgrade will enable the Air Force to fly these aircraft until 2017, or longer, with improved avionics, weapons, and communications systems.

3.8 When purchased in 1980, the CF-18 life expectancy was up to 2003. However, by 1992, after deploying the aircraft to the Gulf War in 1991, the Department had concerns about several deficiencies.

3.9 With ongoing maintenance, some upgrade work, and structural fatigue life management, the Department planned to prolong the life of the pre-modernized fleet to 2010, recognizing it could continue to fly, but its capabilities would be limited. In 1998, National Defence granted internal approval to begin modernizing the CF-18 aircraft fleet through a series of incremental upgrades and modifications. These would occur between 2001 and 2009 and address critical deficiencies such as identifying friend or foe aircraft, effectively interoperating with other aircraft in joint operations, communicating on continually secure channels, and defending against jamming of its radio and radar. The number of aircraft to be modernized was based primarily on affordability. Plans for the 39 remaining aircraft were not finalized at the time of our audit. Some of these aircraft have been used as a source of spare parts.

3.10 In our 2001 Report, Chapter 10, National Defence In-Service Equipment, we reported on the availability of military equipment and looked at the performance of the CF-18. We examined abort rates, which are the number of failures per 1,000 flying hours that result in cancelled missions, and found that the CF-18 was experiencing a growing number of aborts. Aging and reduced funding combined to restrict the performance and availability of these aircraft.

The Department has responded: National Defence agrees with all the recommendations and has committed to taking action to address concerns we raise in this chapter.

Management of Federal Drug Benefit Programs

Chapter 4

Main Points

4.1 Our audit of the federal government's drug benefit programs found a lack of leadership and co-ordination in the provision of drug benefits. The six federal organizations that administer the programs approve most of the same drugs and deliver them through the same pharmacy system in Canada. However, the failure to co-ordinate their efforts has led to missed opportunities to save money and contain costs.

4.2 Studying drug use patterns, and taking appropriate action, can prevent the misuse of drugs and help ensure that clients realize the intended health outcomes of drug benefit programs. The federal government has current, highly informative data on the drug use of each of its clients; however, these data are not being systematically assessed and disseminated to health care professionals. The data provide an important source of medically relevant information for Health Canada, Veterans Affairs, the RCMP, and National Defence, all of whom share responsibility for improving or maintaining the health of their respective clientele, in partnership with industry and service providers. Failure to share this information could result in less than optimal health outcomes for many clients.

4.3 In managing these programs, federal organizations have not taken advantage of known cost-saving opportunities in order to ensure the programs' long-term sustainability. As a result, the government may be spending tens of millions of dollars annually more than necessary.

Other observations

4.4 The federal government is the fourth largest payer of prescription drug benefits in Canada, after Ontario, Quebec, and British Columbia. It spends more than $430 million annually on prescription drugs for about one million Canadians. These costs have risen by 25 percent over the past two years.

4.5 Other than for cost, most federal organizations have neither objectives nor performance measures that are specific to their drug benefit activities. Without specific objectives and related performance information, organizations have no means of assessing whether their activities are meeting intended purposes and are cost-effective.

4.6 Audits of pharmacies have identified significant overcharges owed to the Crown. These amounts owing have not been recorded in the Public Accounts of Canada as required by the Treasury Board Policy on Receivables Management.

The government has responded. Federal organizations agree with all of our recommendations and their responses are included in this chapter. The government has told us that details on actions to be taken will be communicated to us within a few months.

Indian and Northern Affairs Canada
Education Program and Post-Secondary Student Support

Chapter 5

Main Points

5.1 Although Indian and Northern Affairs Canada carried out more studies and undertook several new initiatives in elementary and secondary education, it made limited progress in addressing most of the issues and recommendations raised in our April 2000 Report and in the June 2000 Report of the Standing Committee on Public Accounts. The Department does not know whether funding to First Nations is sufficient to meet the education standards it has set and whether the results achieved are in line with the resources provided. The budget for this program is over $1 billion annually.

5.2 We remain concerned that a significant education gap exists between First Nations people living on reserves and the Canadian population as a whole and that the time estimated to close this gap has increased slightly, from about 27 to 28 years.

5.3 The number of First Nations people having a post-secondary certificate, diploma, or degree continues to grow. However, we found significant weaknesses concerning the Post-Secondary Student Support Program's management and accountability framework. The Department has not clearly defined its roles and responsibilities. The way it allocates funds to First Nations does not ensure equitable access to as many students as possible, and the Department does not know whether the funds allocated have been used for the purpose intended. In addition, the information available on the performance of the program is inadequate. As a result, the Department does not know whether program funds are sufficient to support all eligible students, and it has no assurance that only eligible students taking eligible courses are receiving funding. The budget for this program is about $273 million a year.

5.4 We also noted discrepancies in the information that the Department provided to the Treasury Board about the way the program operates. Moreover, Parliament is not receiving a complete picture of the program and how effective it has been in narrowing the gap in post-secondary education between First Nations and the Canadian population as a whole.

5.5 The Department is currently carrying out a comprehensive review of all its policy and program delivery authorities, including its education programs. This exercise provides the Department and central agencies, in consultation with First Nations and other parties, an opportunity to take a fresh look at the programs' design, administration, and accountability for and reporting of results.

Background and other observations

5.6 The elementary and secondary education of children living on reserves is covered by various statutes, treaties, agreements, and government policy, and it involves numerous players. Indian and Northern Affairs Canada and central agencies establish funding levels, education policy, and delivery requirements. The Department also operates seven schools. Under various funding arrangements with the Department, First Nations deliver education on reserves, arrange to buy education services from local school boards, or use a combination of both. Provinces and school boards provide education to on-reserve children attending schools outside their community. Some students attend private schools. At the post-secondary level, the Department transfers funds to First Nations to provide financial assistance to eligible students, living on or off reserves, to defray the cost of tuition, books, and supplies. When applicable, financial assistance also covers travel and living expenses for full-time students and their dependents.

5.7 Many First Nations students and communities face fundamental issues and challenges that are more prevalent for them than for other Canadians and may impede their educational achievement. For example, most First Nations communities are small, with fewer than 500 residents. Thus, their schools have difficulty providing a range of educational services.

5.8 In addition, the First Nations population is young and growing. According to the Department, about 40 percent of the Registered Indian population is under the age of 19, compared with 25 percent for the Canadian population. The Department projects that the on-reserve Registered Indian population will grow from about 445,000 in 2003 to 700,000 by 2021.

5.9 Education is critical to improving the social and economic strength of First Nations individuals and communities to a level enjoyed by other Canadians. All parties, including the Department, First Nations, provinces, school boards, parents, and the students, need to work together to improve results. We believe that the Department needs to take a leadership role in addressing long-standing issues affecting First Nations education. In particular, the Department needs to urgently define its own role and responsibilities and improve its operational performance and reporting of results.

The Department has responded. The Department accepts all the recommendations. It reiterates its commitment to working with First Nations and other stakeholders to improve the educational outcomes of First Nations students and states that success in First Nations education must be measured over the long term.

Canada Revenue Agency

Resolving Disputes and Encouraging Voluntary Disclosures

Chapter 6 Main Points

6.1 A key activity of the Canada Revenue Agency's Appeals Branch is resolving objections to income tax and GST assessments as well as appeals of Canada Pension Plan (CPP) and Employment Insurance (EI) rulings and assessments. We found that the Branch is resolving most of the income tax and GST objections it receives, and it is doing this in a way that is fair and impartial. As well, over half of the objections are resolved within the timeliness goals that the Agency has set. However, taxpayers can appeal their case to the Tax Court of Canada if they have not received a decision from the Appeals Branch after 90 days. Many of the Branch's timeliness goals for income tax objections exceed 90 days by a large margin.

6.2 The Branch is resolving CPP and EI appeals impartially but has difficulty resolving them in a timely way. The Agency needs to consider a more efficient overall process for dealing with CPP and EI rulings, which are issued by the Revenue Collections Branch, and any related appeals of those rulings, which are dealt with by the Appeals Branch.

6.3 The Appeals Branch also administers the Agency's Voluntary Disclosures Program. The program has encouraged taxpayers and GST registrants to correct past errors or omissions. However, we found that the program is not administered consistently across the country. Further, we are concerned that the Agency has gone beyond what Parliament was told the legislation supporting the program would be used for.

Background and other observations

6.4 Taxpayers and GST (or HST) registrants who disagree with assessments by the Canada Revenue Agency on income tax, GST, and excise tax matters can file an objection with the Agency. Affected parties who disagree with the Agency's rulings and assessments on Canada Pension Plan and Employment Insurance can appeal. These objections and appeals are reviewed by the Agency's Appeals Branch. In 2003–04, appeals officers adjusted about 62 percent of the income tax and GST assessments they reviewed.

6.5 The Voluntary Disclosures Program allows taxpayers and GST registrants to correct inaccurate or incomplete information previously reported to the Agency, or to disclose information not previously reported, without penalty or prosecution and sometimes with reduced interest. Its goal is to promote compliance with the tax laws. The Agency needs to analyze the program's results to ensure that this goal is being met.

The Agency has responded. The Canada Revenue Agency agrees with all of our recommendations. In its responses, it describes actions it will take to address the recommendations.

The Agency disagrees with our concern that it has gone beyond what Parliament was told the legislation supporting the Voluntary Disclosures Program would be used for. The Agency believes that the intent of Parliament is contained in the words of the acts passed by Parliament.

Process for Responding to Parliamentary Order Paper Questions

Chapter 7

Main Points

7.1 The written questions (order paper questions) that members of Parliament submit to the government are an important part of the parliamentary system. They are among the tools that members of Parliament can use to hold the government to account. In February 2004, the Governor in Council asked our Office to carry out an audit of the second response to Order Paper Question 37, provided in January 2004. It relates to transactions with the holdings of the blind management agreement of the former Minister of Finance. In preparing its response the government used the time period of January 1993 to October 2003, which was the longest time period possible for the response.

7.2 Except for the effect of the practices noted below, we have concluded that the process was sufficient for the response to Order Paper Question 37 dated 28 January 2004, in the amount of $161 million, to be reasonably complete with respect to grants, contributions, and contracts from the government. Port authorities, as shared governance organizations, were not asked to respond to Question 37 because, in the opinion of the government, these kinds of organizations are not considered to be part of government. In our opinion the port authorities, which are included in the Public Accounts of Canada as part of the government, are agencies of government and should have been tasked with responding to the question. We cannot quantify the effect on the government's response of the practice of not seeking information from all relevant organizations.

7.3 The government exercised considerable oversight in developing the second response to Question 37. We noted that the process followed was more rigorous than for the first response. While recognizing the limitations of government systems and the difficulties in responding to questions that cover long periods of time, we noted that there was room for improvement.

7.4 In addition, the response did not include the government's guarantee of a $10 million loan by a commercial bank to a company included in the holdings of the blind management agreement of the former minister of Finance between November 1993 and November 1994. The loan guarantee was issued in June 1993, before the start date of the blind management agreement in November 1993. The CSL Group Inc., which was one of several companies that had a minority interest in the company, disposed of its interest in November 1994. The government, which was the majority shareholder in the company, made no payments in connection with this guarantee.

7.5 In March 2004, as a result of difficulties encountered in preparing a response to Question 37, the Government House Leader announced a series of reforms intended to ensure that parliamentarians would receive adequate information in responses to their questions. For example, the Privy Council Office may designate a lead department to co-ordinate, review, and validate responses to complex, horizontal questions that involve several departments and agencies. Also, the Privy Council Office is now asking departments to designate a senior official to sign a statement of completeness certifying that the information in the response is complete and accurate. While these are positive initiatives, they have yet to be fully implemented.

7.6 In addition to Question 37, we audited four other order paper questions. We have concluded that the process used to answer those four questions, as was the case for the first response to Question 37, led to incomplete responses. The reasons for the incomplete responses include the following:

- Key terms were not defined by the Privy Council Office.
- There was a lack of appropriate level of care by departments in searching for information.
- There was a failure of organizations to provide the requested information in their responses.

This conclusion cannot be generalized to responses to all order paper questions.

7.7 Additional measures, beyond those announced by the government in March 2004, are needed to strengthen the process of responding to order paper questions. Such measures would include, for example

- clarifying the questions to ensure more relevant, useful responses;
- providing members of Parliament with contextual information and the limitations in preparing the response;
- obtaining full responses from all relevant Crown corporations;
- strengthening departmental search procedures;
- presenting responses in an aggregated format, which could be more useful to a member of Parliament; and
- updating the Privy Council Office's process for tracking questions and responses.

7.8 In the case of Question 37, we noted that the process for completing the public declaration of declarable assets should be strengthened by requiring the trustee to certify that the information provided to the Office of the Ethics Commissioner is complete.

7.9 The government should address the recommendations set out in this report to strengthen the process that supports an important aspect of our Parliamentary system of government—the right of members of Parliament to receive the information necessary to hold the government to account.

Background and other observations

7.10 The Government of Canada is a large and complex organization. Information systems vary within departments and across government. It can therefore be difficult to get complete and accurate information to answer questions from members of Parliament, particularly those that ask for information over longer periods of time.

7.11 The government faces a significant number of challenges in responding to order paper questions. These include

- changes in the structure of government departments over time,
- changes to government information systems and the introduction of new systems,
- the government's policy of retaining records for the current year and the previous six years, and
- departmental information systems designed to meet management's needs and not necessarily structured in a way that supports responses to order paper questions.

The government has responded. The government is in agreement with our recommendations. Its responses are included throughout the chapter.

Other Audit Observations

Chapter 8

Main Points

8.1 This chapter fulfills a special role in the Report. Other chapters normally report on performance audits or on audits and studies that relate to operations of the government as a whole. Other Audit Observations discusses specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our performance audits or audit work to follow up on third-party complaints. Because these observations deal with specific matters, they should not be applied to other related issues or used as a basis for drawing conclusions about matters not examined.

8.2 This chapter covers one new issue:

- Telefilm Canada—The majority of the activities of Telefilm Canada are not consistent with its Act.

8.3 The Standing Committee on Public Accounts has requested that we continue to bring to Parliament's attention previous observations that have not been resolved. In this Report, we follow up on two of these observations:

- The surplus in the Employment Insurance Account—Non-compliance with the intent of the *Employment Insurance Act*;
- Parc Downsview Park Inc.—Unresolved issues related to the transfer of Downsview lands and the financing of Downsview Park's future operations.

Report of the Auditor General of Canada to the House of Commons—November 2004

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2004

Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 1

Internal Audit in Departments and Agencies

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

1

Internal Audit in Departments and Agencies

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Internal Audit in Departments and Agencies

Main Points

1.1 We assessed the extent to which internal audit groups in six federal organizations had met professional standards and complied with the Treasury Board Policy on Internal Audit. We found that it varied considerably across these organizations.

- In two organizations (Public Works and Government Services Canada and the Royal Canadian Mounted Police), the internal audit group generally met the *International Standards for the Professional Practice of Internal Auditing*.
- Three departments partially met the standards (Foreign Affairs and International Trade, Human Resources Development Canada, and Natural Resources Canada).
- One agency did not meet many of the standards (Canadian International Development Agency).

1.2 Our work identified a number of important factors that, if implemented, could have a positive influence on the quality of internal audit across government:

- a consistent understanding on the part of senior management of the role that internal audit can and should play;
- a departmental audit committee with external members who are independent of management;
- a clear human resource strategy at the department, central agency, and government level that sets out the qualifications and appropriate number of staff for the internal audit community;
- a focus on assurance services; and
- a strategy to ensure appropriate internal audit coverage and capacity in small entities.

1.3 We found that the Treasury Board Secretariat has yet to establish and fund a strategy that will enable it to meet the requirements of the Policy on Internal Audit and the expectations of the internal audit community.

Background and other observations

1.4 Internal audit is an important element in enabling deputy heads to ensure that their departments have an effective internal control system. Internal auditors conduct risk-based audits and identify, where necessary, improvements in an organization's risk management strategy and practices, in its management control framework, and in the information systems it uses for decision making and reporting.

1.5 Effective 1 June 2004, the government re-established the Office of the Comptroller General to strengthen comptrollership and oversight across the federal government. The Comptroller General's key duties include setting or reviewing auditing standards and policies of the Government of Canada, providing leadership to ensure and enforce appropriate financial controls, and promoting sound resource stewardship at all levels across the federal government.

The Treasury Board Secretariat has responded. The Secretariat agrees that improvement is required. The government has directed the Secretariat to establish a more effective government internal audit function. As a result, the Comptroller General is currently developing proposals to ensure that the Canadian public service has a high performance internal audit regime. These proposals address many of our recommendations and are described following the conclusion.

Introduction

Independence—The freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional, and organizational levels.

Objectivity—An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgement on audit matters to that of others.

Internal auditing—Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

Source: The Institute of Internal Auditors, *The Professional Practices Framework*

1.6 An effective internal audit function is a fundamental component of good governance. It can provide senior management and audit committees with assurance about the efficiency and effectiveness of key financial, administrative, and operational activities and the organization's management practices, along with suggestions for improvement.

1.7 Internal audit is one of several tools that an organization may use to assess and monitor management practices and the achievement of its objectives. Other tools include program evaluation, studies, and management's efforts to monitor how adequate and effective its own practices are.

1.8 What distinguishes internal audit from other activities that review departmental practices are its attributes of independence and objectivity.

1.9 In recent years, the professional practice of internal auditing has undergone tremendous change. In June 1999, the Institute of Internal Auditors adopted a new definition for internal auditing. This definition incorporated an assurance and consulting role for internal audit. In January 2002, the Institute also adopted a new professional practices framework.

1.10 While the federal government's internal audit community has had to respond to changes within the profession, it has also had to respond to issues within the federal government. Among these are initiatives such as the *Independent Panel's Report on the Modernization of Comptrollership within the Government of Canada*, which emphasized the role of internal audit in providing assurance services to senior management.

Assurance services—An objective examination of evidence for the purpose of providing an independent assessment on risk management strategies and practices, control frameworks and practices, and information used for decision making and reporting.

Source: Treasury Board Policy on Internal Audit

1.11 In responding to these issues and in trying to strengthen the government's internal audit capacity, the Treasury Board of Canada adopted a revised Policy on Internal Audit in April 2001.

1.12 The revised Policy was to be a first step toward fulfilling the government's commitment to have a stronger, better-positioned internal audit function. To this end, the Treasury Board Secretariat invested more than $33 million over the four-year period 2001–02 to 2004–05 to help implement the Policy in departments and agencies. It used another $11 million to fund the Centre of Excellence for Internal Audit. In 2002–03 the total budgeted expenditure for internal audit was $54 million, which included $15 million of supplementary funding provided by the Secretariat.

Roles and responsibilities of internal audit

1.13 The revised Policy on Internal Audit requires departments to

- have an effective, independent, and objective internal audit function that has the resources necessary to provide sufficient and timely assurance services on all important aspects of their risk management strategies and practices, their management control frameworks and practices, and the information used for decision making and reporting;

- incorporate internal audit results into their priority-setting, planning, and decision-making processes; and
- issue completed reports in a timely manner and make them accessible to the public with minimal formality in both official languages.

1.14 The Policy sets out specific requirements for internal audit groups, deputy heads, and the Treasury Board Secretariat's Centre of Excellence for Internal Audit. Internal audit groups are to conduct their work according to the Policy and the *International Standards for the Professional Practice of Internal Auditing*, established by the Institute of Internal Auditors. According to the Policy, the focus of the work of internal audit groups is to provide assurance services to departmental senior management on the effectiveness of risk management strategy and practices, management control frameworks and practices, and information used for decision making and reporting.

1.15 Under the Policy, deputy heads' responsibilities include

- establishing an active audit committee;
- ensuring independence in their organization and in the activities of their internal audit groups;
- ensuring that internal audit reports describe management action plans to address any weaknesses that internal audit has identified;
- following up to ensure that recommendations have been acted on;
- providing the Secretariat with copies of annual internal audit plans and completed internal audit reports; and
- informing the Secretariat, on a timely basis, of significant issues relating to risk, control, or problems with management practices.

1.16 The Secretariat, through its Centre of Excellence for Internal Audit, is to provide advice to deputy heads, heads of internal audit, and internal audit practitioners on the Policy and practices of internal audit. The Policy on Internal Audit also directs the Centre

- to establish an active monitoring process to provide the Secretariat with timely information on significant issues of risk,
- to develop a human resource strategy for the internal audit community, and
- to establish a framework for evaluating whether the objectives of the Policy on Internal Audit are being achieved.

Focus of the audit

1.17 Our audit focussed on assessing the extent to which a sample of departments and agencies were complying with the Treasury Board's Policy on Internal Audit, which requires departmental internal audit groups to meet professional standards. We also looked at the role of the Secretariat's Centre of Excellence for Internal Audit in providing leadership and direction to the internal audit function in departments and agencies.

1.18 The organizations in which we conducted a quality assessment review were

- the Canadian International Development Agency,
- Foreign Affairs and International Trade (on 12 December 2003, this Department was divided into two departments—Foreign Affairs Canada and International Trade Canada),
- Human Resources Development Canada (on 12 December 2003, this Department was divided into two departments—Human Resources and Skills Development Canada and Social Development Canada),
- Natural Resources Canada,
- Public Works and Government Services Canada, and
- the Royal Canadian Mounted Police.

For more information about our objectives, scope, approach, and criteria, please see **About the Audit** at the end of the chapter.

Observations and Recommendations

1.19 Our audit involved carrying out quality assessment reviews in six departments and agencies (Exhibit 1.1). These reviews allowed us to rate the extent to which the organizations in our sample were meeting the *International Standards for the Professional Practice of Internal Auditing* and complied with the Treasury Board's Policy on Internal Audit. We found that two departments generally met the professional standards, while three partially met them. One agency did not meet many of the standards. Exhibit 1.2 provides a definition of the rating scale used in our audit.

Exhibit 1.1 Results of our quality assessment reviews in six departments and agencies

Organization	Generally conforms to the standards	Partially conforms to the standards	Does not meet many standards
Public Works and Government Services Canada	●		
Royal Canadian Mounted Police	●		
Foreign Affairs and International Trade		●	
Human Resources Development Canada		●	
Natural Resources Canada		●	
Canadian International Development Agency			●

Exhibit 1.2 Definition of the rating scale used in our quality assessment review

Generally conforms to the standards—The relevant structures, policies, and procedures of the internal audit group, as well as the processes by which they are applied, complied with the requirements of the Standards. While there may be opportunities for improvement, these did not represent situations where the internal audit group had not implemented the Standards, did not apply them effectively, or did not achieve their stated objectives.

Partially conforms to the standards—The internal audit group has fallen short of achieving some of their major objectives. These will usually represent some significant opportunities for improvement in effectively applying the Standards and/or achieving their objectives. Some of the deficiencies may be beyond the control of the internal audit group and may result in recommendations to senior management or the board of the organization.

Does not meet many standards—The internal audit group is not achieving many of the objectives of the Standards. These deficiencies will usually have a significant negative impact on the internal audit group's effectiveness. They may also represent significant opportunities for improvement, including actions by senior management or the board.

Source: Institute of Internal Auditors, *Quality Assessment Manual*, 4th Edition

1.20 The primary reasons for the ratings given to the internal audit groups in each department or agency include, but are not limited to, those described below:

- **Public Works and Government Services Canada** generally conformed to professional standards. There was organizational independence and strong support from senior management. The internal audit group reports directly to the deputy head. The audit committee also includes one external independent member. A review of a sample of audit working papers revealed that the auditors exercised due professional care. The Department has also developed a management control framework that assists the internal auditors in evaluating the effectiveness of key areas of management, such as risk management, control, and governance processes. Its internal audit manual establishes quality assurance practices. The Department plans to strengthen its quality assurance and improvement program for the internal audit function.
- **The Royal Canadian Mounted Police** generally conformed to professional standards. We saw strong support from senior management. The head of internal audit reports administratively to the Deputy Commissioner, Corporate Management and Comptrollership and functionally to the Commissioner (deputy head). The internal audit function also has direct access to a well-functioning audit committee, which contributes to the independence of internal audit. The Commissioner is leading efforts to strengthen the internal audit function at the RCMP. A review of a sample of audit files revealed well-prepared audit working-papers and that the auditors had exercised due professional care. One of the strengths of the internal audit group is the operational experience and professional qualifications of the internal

auditors. A strong internal quality assurance program has been established within the internal audit group. Further, a comprehensive internal audit professional training plan is being developed to ensure that audit staff develop the qualities and competencies of an effective "best in class" internal audit organization.

- **Foreign Affairs and International Trade** partially conformed to professional standards. In December 2003, the Department was reorganized and split into two departments: Foreign Affairs Canada and International Trade Canada. Our work relates to the previous organizational structure. Under the reorganized structure, the internal audit group will audit both entities. The internal audit function has a clearly established mandate and is independent with direct reporting to the deputy head. The Department's internal audit group also has a strong professional development program for its staff and a requirement for new junior staff to supplement their existing background and skills with a professional designation. However, the group lacks a formal quality assurance process, which, if implemented, could strengthen the effectiveness of the internal audit function. The Department develops its audit plan through a consultation process with senior management. It has started to develop a formal, risk-based audit plan to identify areas of risk.

- **Human Resources Development Canada** partially conformed to professional standards. In December 2003, the Department reorganized and split into two departments: Human Resources and Skills Development Canada, and Social Development Canada. Our work relates to the previous organizational structure. The previous department had a strong quality assurance process. The effectiveness of internal audit could be improved by strengthening its organizational independence and having the group report directly to the deputy head. Internal audit spends considerable time developing management standards documents which will serve as criteria for future audits and in assisting the Department to implement integrated risk management as part of the comptrollership initiative. As a result of these efforts, the amount of assurance audit work being carried out is limited.

- **Natural Resources Canada** partially conformed to professional standards. The internal audit group has gone through significant and continuous turnover during the last three years. The Department met many of the components of standards, such as organizational independence, proficiency and due care, and performance standards. However, the departmental policy for audit and evaluation is very broadly stated. The purpose, authority, and responsibility for internal audit should be defined and consistent with the Treasury Board's Policy on Internal Audit and the professional standards. Natural Resources Canada lacks a formal, internal, quality-assurance process, which could strengthen the effectiveness of internal audit. A review of a sample of audit files indicated that recently completed audits had appropriate supporting working-paper files, while older files did not.

- **The Canadian International Development Agency** did not meet many professional standards. Its internal audit group reports to a person who is responsible for other management activities. This does not in our opinion provide sufficient independence for the group. Also internal audit has not established internal quality assurance processes that cover all aspects of the internal audit activity as required by professional standards. We reviewed a sample of audit files. We found that, for two of the three files, the documentation for the audit work completed was not maintained in a way that clearly demonstrates the work conducted and that the evidence collected supported the internal audit report at the time the report was issued. The Agency has recently made changes that demonstrate its commitment to strengthen its internal audit function. For example, the audit committee, now chaired by the President, is demanding a shorter audit cycle and quicker management responses to concerns raised by internal audit. Since our audit, the Agency has taken steps to address our concerns. We will conduct another quality assessment review to follow up on progress made by the Agency.

1.21 Overall, the quality of the internal audit function varies widely in these organizations.

1.22 A number of factors have contributed to preventing internal audit groups from contributing as much as they could. These include a lack of support from senior management, difficulties in attracting and retaining qualified staff, and limited number of assurance audits being conducted. Our previous audits have highlighted these challenges, which continue to adversely affect the internal audit function.

Sustained support from senior management

1.23 Strong, sustained support from senior management is the single most important element in building an effective, independent internal audit function. Ideally, the head of internal audit should report directly to the deputy head. This positions internal audit to play a more independent and strategic role, which extends beyond performing audits. It also reflects the attitude and expectations of senior management with respect to internal audit, and promotes independence and objectivity by placing an appropriate distance between the auditor and operational managers.

1.24 Having a properly staffed and positioned internal audit allows the auditors to review activities with an independent and objective perspective because they are not responsible for those activities. Internal audit should provide an organization with assessments and opinions on the accuracy, completeness, and effectiveness of processes and information. If internal auditors are too heavily involved in developing a process or overseeing operational effectiveness (for which management is responsible), then their independence and objectivity are compromised.

1.25 The Treasury Board's Policy on Internal Audit recognizes the value of strong support from senior management. It requires deputy heads to institute an effective audit function that plays a strategic role, including providing assurance on the quality of

- a department's risk management and control frameworks, and
- the information that managers use to make decisions and report on the organization's performance.

1.26 The Policy also expects senior management to use the results of internal audits in planning and setting priorities. Meeting these requirements would require the deputy head to create an appropriate reporting relationship and to understand and value what internal audit does. Best practices for internal audit support direct reporting to the most senior level of management.

Senior management support is strong in some departments

1.27 We found that three (Foreign Affairs and International Trade, Natural Resources Canada, and Public Works and Government Services Canada) of the six organizations had internal audit groups that reported to their deputy head.

1.28 The senior management of some government organizations strongly and visibly support their internal audit group. This was particularly evident for the Royal Canadian Mounted Police (RCMP) and Public Works and Government Services Canada (PWGSC). For both organizations, senior management clearly understood and supported the role of internal audit in the management process.

1.29 For example, the RCMP's senior management decided that it wanted to create a stronger, more effective, and highly professional internal audit group. To achieve this goal, senior management purposely recruited a number of audit staff with strong credentials and appropriate professional designations. This enabled the internal audit staff to assume a more strategic role in supporting senior management and demonstrated the value they added to the organization.

1.30 Internal audit in PWGSC and the RCMP generally conformed to the *International Standards for the Professional Practice of Internal Auditing*. An effective internal audit function correlates strongly with clear support from senior management and direct reporting to the deputy head.

Strategic orientation of internal audit

1.31 If internal audit in the government is to operate effectively and contribute to improving the management of departments, it must have a strategic orientation. Whether it achieves this orientation will depend on two important factors: internal audit's positioning and reporting relationship within the department and viewing its role as strategic.

1.32 The proper positioning (or organizational alignment) can give an internal audit group the organizational independence and the mandate to deal with significant, strategic business risks.

1.33 Internal audit contributes to better governance when it assumes a strategic orientation by working closely with the audit committee and senior management to address organization-wide risk, governance, and control issues. To be effective, internal audit groups need to move from a tactical level to a strategic level. They need to align their resources and provide assurance on risk, governance, and control of business processes that support the organization's objectives and that demonstrate the value that internal audit adds.

1.34 A close working relationship with senior management, along with their visible support, signals that they value the expertise that internal audit brings to their organization. Such a relationship can strengthen the perception of the independence and objectivity of an internal audit function. Equally, its absence can diminish the perception of a strong, independent internal audit.

Audit committees and internal audit

1.35 Another key factor that influences the quality and effectiveness of the internal audit function is the departmental audit committee. According to the Treasury Board's Policy on Internal Audit, a departmental audit committee has an important oversight role to play in internal audit. This includes oversight of the internal audit group, strengthening its independence, and monitoring its performance.

1.36 Audit committees in private firms and various public organizations are commonly responsible for overseeing other areas in which the internal audit group is involved. These areas include the oversight of the organization's risk management, governance, and management control frameworks, and ensuring the integrity of financial and performance information used for decision making and external reporting. Given these responsibilities, audit committees play a key role in corporate governance.

Departmental audit committees lack independence

1.37 The degree of independence of internal audit in an organization reflects the independence of the audit committee that oversees it. In the private sector and Crown corporations, audit committees consist of members who are independent and are separate from management (Exhibit 1.3). Given that private sector audit committees are responsible for overseeing internal audit, their independence, in turn, helps ensure that internal audit remains independent. In the private sector, the expectations placed on audit committees has increased after recent financial collapses in several high-profile corporations.

Exhibit 1.3 Audit committee guidance

- The audit committee of every board of directors should be composed only of outside directors.
- The roles and responsibilities of the audit committee should be specifically defined so as to provide appropriate guidance to its members on their duties.
- The audit committee should have direct access to the internal and external auditors to discuss and review issues, as appropriate.
- The audit committee's responsibilities should include oversight of management's reporting on internal control. While it is management's responsibility to design and implement an effective system of internal control; it is the responsibility of the audit committee to ensure that management has done so.

Source: Toronto Stock Exchange

1.38 Under the Treasury Board's Policy on Internal Audit, the deputy head either chairs the audit committee or chooses a senior executive (usually the associate deputy minister) to chair the committee. The committee is to consist of three to five other members at the assistant deputy minister level. Accordingly, committee members may sometimes be audited, which places them in a position of conflict of interest and may diminish their objectivity. In our view, this independence would be less at risk if departmental audit committees were required to include members from outside the organization. Exhibit 1.4 shows the membership in the audit committees of the six organizations we audited. In other jurisdictions such as the United Kingdom and the United States, steps are being taken to strengthen the independence of departmental audit committees by establishing requirements for independent members and measuring the performance of the audit committee.

Exhibit 1.4 Membership in the audit committees of the six organizations we audited

Organization	Committee chair	Internal members	External members
Canadian International Development Agency	President	14	0
Foreign Affairs and International Trade	Associate deputy minister	14	0
Human Resources Development Canada	Associate deputy minister	13	0
Natural Resources Canada	Deputy minister	13	0
Public Works and Government Services Canada	Deputy minister	8	1
Royal Canadian Mounted Police	Commissioner	11	0

These figures do not include observers who attend committee meetings; for example, a representative of the Treasury Board Secretariat or an external auditor from the Office of the Auditor General of Canada.

Source: Departmental records

1.39 In past audits we have recommended that departmental audit committees include outside members to add to their independence. However, only Public Works and Government Services Canada has acted on the recommendation. The Policy on Internal Audit is silent on this matter, although a Treasury Board Secretariat reference document does recommend that deputy heads consider appointing suitably qualified external members to audit committees.

1.40 **Recommendation.** The Treasury Board Secretariat should establish in the Treasury Board's Policy on Internal Audit a requirement for external membership on departmental audit committees.

The Secretariat's response. The Secretariat agrees that external members could make a significant contribution to supporting the independence of departmental internal audit functions and providing deputy heads with objective advice and guidance. This recommendation will be addressed through revision of the Policy on Internal Audit.

Not all audit committee members understand their role

1.41 The Policy on Internal Audit sets out the roles and responsibilities of audit committees. We found that senior management and members of audit committees do not always fully understand their roles and responsibilities. Exhibit 1.5 lists the roles and responsibilities of departmental audit committees for internal audit, as set out in the Policy.

Exhibit 1.5 Roles and responsibilities of departmental audit committees

Roles. The roles of the audit committee include

- providing advice and counsel to assist the deputy head in discharging his or her responsibilities for risk management, the design and operation of management control frameworks, and the quality of financial and other performance information used for decision making and reporting;
- ensuring that the results of internal audit are incorporated into the departmental priority setting, planning, and decision-making processes;
- strengthening the independence and effectiveness of the internal audit function;
- emphasizing the accountability of managers;
- providing the deputy head with advice on the impacts of government-wide initiatives aimed at improving management practices; and
- facilitating communication between senior management, the internal audit function, central agencies, and the Office of the Auditor General.

Responsibilities. The responsibilities of each audit committee need to be determined by each department. Within the department these responsibilities could include

- approving the internal audit policy,
- approving the annual internal audit plan and budget,
- approving the annual assessment of overall materiality and risks associated with the annual internal audit plan,
- approving internal audit reports and the management action plans that address the recommendations made in the audit reports,
- approving management action plans that address recommendations contained in reports of the Office of the Auditor General,
- monitoring the adequacy and timeliness of actions made in the management action plans,
- identifying the implications of audit issues and priorities raised by central agencies and other government organizations, and
- monitoring the performance of the department's internal audit function.

Source: Treasury Board Policy on Internal Audit

1.42 One of the responsibilities of an audit committee is to monitor the performance of internal audit. We noted that the RCMP regularly provided the audit committee with information on the performance of internal audit with a balanced scorecard.

1.43 Another responsibility of audit committees is to approve the annual audit plan and the overall risks associated with the plan. We found that organizations are preparing risk-based plans for audit committee approval. In approving these audit plans, committee members need to be aware of the relationship between the plans and the risks that could affect departmental operations. We found that members did not consistently have a good understanding of this relationship.

1.44 From time to time it is expected that audit committee members will need to act in a challenge role. In five of the six organizations that we audited, the membership of the audit committee was substantially the same as the executive committee. This does not allow the audit committee to effectively fulfill its challenge role. If management and the audit committee are substantially the same, the committee may lack the necessary objectivity.

1.45 A number of audit committee members that we interviewed expressed a need to better understand their role. Only the RCMP offers formal training to help its members understand their roles and responsibilities. The Director General, Audit and Evaluation, provides training to committee members on internal audit's mandate and organizational structure, the services it provides, the concept of a risk-based audit plan, and the performance measures for internal audit. Also, audit committee members are given a "walk-through" of the Internal Audit Charter and their terms of reference.

1.46 We reviewed the guidelines for audit committees in the Treasury Board Policy on Internal Audit and found that the Treasury Board has adopted a narrower role for audit committees than the private sector and other jurisdictions. Also, the expectations of audit committees in the private sector and in other jurisdictions has evolved in recent years. For example, departments will, within the next five years, be required to prepare annual financial statements that can withstand the test of an audit. In addition, the Treasury Board Accounting Standard 1.2—Departmental and Agency Financial Statements requires the deputy head and the senior financial officer to sign off on the financial statements—this acknowledges management's responsibility for the financial statements and the processes that produce the information in the statements. In other jurisdictions and in the private sector, the audit committee plays a key role in supporting management in discharging this responsibility and in ensuring the accuracy, integrity, and completeness of the financial reporting. Fulfilling this role will require audit committee members to have a certain degree of financial expertise and knowledge of generally accepted accounting principles.

1.47 A summary of some key expectations in other jurisdictions and not covered by the Policy on Internal Audit is provided in Exhibit 1.6.

Exhibit 1.6 Key responsibilities of audit committees in other jurisdictions

Financial and other reporting

- providing assurance to the executive management committee (the governing body) on the reliability of financial information reported by management
- reviewing financial and/or fiscal policy decisions
- reviewing financial statements and management letters
- overseeing external audit coverage
- reviewing other reports requiring governing body approval

Risk management

- monitoring the adequacy and effectiveness of strategies to manage corporate risk

Management control framework

- monitoring the adequacy and effectiveness of the internal management control structure

Compliance with laws, regulations, and ethics

- providing assurance that the entity is complying with pertinent laws and regulations, is conducting its affairs ethically, and is maintaining effective controls to prevent conflicts of interest and fraud

Source: The Institute of Internal Auditors, *The Audit Committee in the Public Sector; The Audit Committee Handbook*, HM Treasury, United Kingdom

1.48 **Recommendation.** The Treasury Board Secretariat should, as necessary, provide guidance on better practices for audit committee performance and provide guidance on appropriate training for departmental audit committee members.

The Secretariat's response. The current Policy on Internal Audit envisages a wide role for departmental audit committees in providing oversight and advising deputy heads on departmental control and accountability systems. The Secretariat agrees that further guidance and training for committee members are required and will provide support to departments in this area.

1.49 **Recommendation.** The Treasury Board Secretariat should update the roles and responsibilities of the audit committee and its members.

The Secretariat's response. Agreed. The Secretariat is currently developing proposals that will redefine the roles and responsibilities of the audit committee and its members, and will accommodate the involvement of external members.

Staffing internal audit

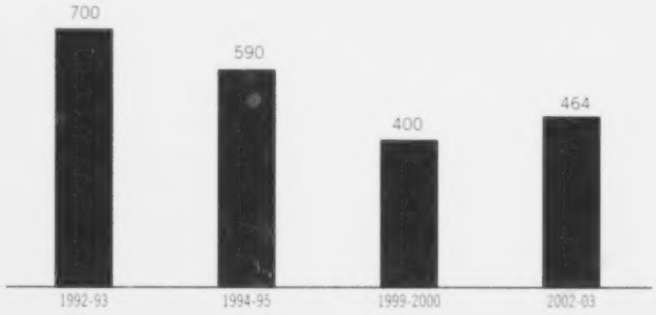
1.50 For most internal audit groups, human resources management poses the greatest challenge. Internal audit groups require an appropriate number of staff who have a broad range of skills, knowledge, and experience. The number of staff depends on the risk and on the activities to be audited.

1.51 The Policy on Internal Audit requires deputy heads to establish an internal audit group that has appropriate resources and meets professional standards. Under the Policy, deputy heads are accountable for ensuring that the internal audit group has the capacity to fulfill its responsibilities—sufficient resources and appropriately qualified staff—and that staff work to professional standards.

1.52 The internal audit community faces significant challenges with human resources. Departments have generally had difficulty attracting and retaining enough qualified people to fill positions in internal audit and to meet the requirements of the Policy on Internal Audit. In February 2003, the Secretariat released a report on the *Interim Evaluation of the Implementation of the Revised Policy on Internal Audit*. The report noted many of the same concerns that we raise in this chapter.

1.53 From 1992–93 to 1999–2000, the number of internal audit staff working in departments and agencies decreased sharply—from 700 to 400 (Exhibit 1.7). Since the Treasury Board issued its revised Policy in 2001, the number of audit staff has recovered to about 464 in 2002–03. For consistent presentation these figures include resources at Canada Customs and Revenue Agency, which became a separate agency in 1999. Of the 400 staff in 1999–2000, 285 were from departments and agencies subject to the Policy and 115 were from the Agency. Of the 464 staff in 2002–03, 350 were from departments and agencies subject to the Policy and 114 were from the Agency.

Exhibit 1.7 Internal audit staff working in departments and agencies



Source: Departmental records

1.54 The increase in internal audit staff from 1999–2000 to 2002–03 was a result of interim supplementary funding from the Secretariat. Over the last three years, audit groups have used some of these funds to hire and train new people.

1.55 To date, the Secretariat, in conjunction with departments, has not established what the appropriate number of internal auditors should be within the federal government. However, in signed memoranda of understanding between the Secretariat and most departments, there has been a commitment to "fill a persistent gap that remains between the current level of permanent resources devoted to the function and the level required to support a mature or sustainable function." This "sustainable function" is to be achieved by 2005–06.

1.56 We recognize that establishing the appropriate number of auditors is difficult and can never be precise; it is nevertheless critical that clear targets be set. One impact of the shortfall in the number of auditors is that departments may not be carrying out all planned audits of high-risk areas. As a result, departments may be operating with levels of risk that exceed their risk-tolerance levels.

1.57 **Recommendation.** The Treasury Board Secretariat, in collaboration with departments, should establish benchmarks to determine the number of internal auditors that the federal government and each department needs to provide a reasonable level of audit coverage and a sustainable audit function.

The Secretariat's response. Benchmarking across departments and agencies that have widely different risk profiles is extremely difficult. There is no easy formula that will meet everyone's needs. Nonetheless, the Secretariat will work with departments to assist them in determining adequate levels of resources for their internal audit functions.

Impediments to recruiting and retaining internal audit staff

1.58 In the interim evaluation report, the Secretariat noted that departments have offered various reasons for their problems in staffing auditors. They include

- The classification category does not appropriately reflect the skills and competencies required of a professional in the internal audit group. The salary structure is not competitive enough to attract and retain staff with professional designations, appropriate business knowledge, and other specialized skills appropriate to the department.
- The Secretariat's interim funding has created many term positions in departments. The temporary nature of these positions may not be attractive to some employees with professional designations.

1.59 The Secretariat has yet to resolve these issues. The Secretariat's interim evaluation report cited the lack of sufficient staff with appropriate skills in internal audit groups as one of the primary barriers to implementing its Policy on Internal Audit. We concur with this assessment.

A broad mix of skills is needed

1.60 A broad range of skills is needed for an effective internal audit group. The necessary skills include staff with a professional designation and staff with specialized knowledge and expertise and whose skills correspond to the business side of a department.

1.61 The proportion of internal audit staff with a professional designation in the Canadian federal government is comparable to those in government organizations that participate in the Institute of Internal Auditors' Global Audit Information Network, a benchmarking service of the Institute.

Participants in the network reported that 40 percent of staff had a professional designation; in the Canadian federal government, 37 percent of staff had a professional designation.

1.62 What is important is to determine the appropriate number of internal auditors and the mix of skills and experience needed to provide the optimal internal audit coverage on a department and government-wide basis, and the training that would be needed to maintain these skills at an appropriate level. Both the *Interim Evaluation of the Implementation of the Revised Policy on Internal Audit* and the heads of internal audit that we interviewed noted difficulties in attracting and retaining staff.

1.63 **Recommendation.** The Treasury Board Secretariat, in collaboration with departments, should determine the appropriate mix of qualifications, experience, and skills required for internal audit on a department and government-wide basis.

The Secretariat's response. The appropriate mix of qualifications, experience, and skills will vary from department to department. However, as with recommendation 1.57, the Secretariat will work with departments to ensure that internal audit groups have the qualifications, experience, and skills to provide internal audit services at a professional level.

1.64 **Recommendation.** The Treasury Board, in collaboration with departments, should ensure that internal auditors receive the necessary training to maintain their skills at an appropriate level.

The Secretariat's response. The Secretariat currently provides a series of professional internal audit courses for departmental internal auditors, some in conjunction with the Institute of Internal Auditors. These complement the many training opportunities provided by departments. The Secretariat fully recognizes the necessity of training to maintain and enhance the professionalism of internal audit and plans to augment its professional development initiatives.

Audit coverage

1.65 The term "audit coverage" refers to the areas that internal auditors are responsible for examining in their audits. The Policy on Internal Audit identifies the primary role and responsibility of internal audit in the government as the provider of professional assurance services to senior management.

Limited assurance work is being done

1.66 In the private sector, an internal audit group would spend most of its time doing assurance work. Other activities, such as "directed audits" (audits requested by management) and assignments that include consulting work, account for a relatively small percentage of its work. However, in the federal government, in general only a limited amount of time is spent providing assurance services to inform senior management on how well its risk management strategies and practices, management control frameworks and practices, and information for decision making and reporting systems are working.

1.67 Work other than assurance services may provide some useful information for senior management. However, according to the Treasury Board's Policy on Internal Audit, providing assurance through audits is the core expectation of internal audit. If internal audit is not focussing on assurance, it is not doing what it is supposed to. Departments are not benefiting from systematic assessments of their management systems, and senior management is not getting independent assurance that those systems, critical to program delivery, are operating effectively and as intended.

Internal audit coverage in small entities

1.68 Our audit also considered the extent of audit work being carried out in small entities. The federal government has numerous small agencies, boards, and commissions. The activities of these organizations are diverse—from environmental assessment to transportation safety. They perform investigatory, regulatory, and quasi-judicial roles. Although they have relatively few staff and small budgets, these organizations affect the health, safety, and quality of life of Canadians. For example, some agencies provide Canadians with recourse to perceived unfairness and inequity; others strive to make Canadian industry more competitive.

1.69 A key characteristic of these small agencies is that their staff, because they are few in number, may be responsible for more than one area. This differs from larger organizations where roles and responsibilities are generally discrete or segregated. Another characteristic is their informal structures and governance mechanisms.

1.70 Our Office, in developing a new strategy for auditing small entities, looked at the nature and extent of these entities' internal audit capacity. We found that, given their small size, none had a permanent full-time internal audit function. We did note that some small agencies had contracted out audits to meet the specific needs of their management. In general, however, internal audit coverage was very limited.

1.71 In our view, small entities do require some internal audit coverage to provide assurances to management that they are effectively managing the key risks that they face. The Standing Committee on Public Accounts expressed a similar view in its report on our audit of the Office of the Privacy Commissioner of Canada, presented to Parliament in April 2004. It recommended "that the Treasury Board Secretariat create a pool of resources to make central internal audit services available to small departments and agencies, including the Office of the Privacy Commissioner of Canada."

1.72 We reviewed the activities of the Secretariat to determine what it had done to respond to the Public Accounts Committee's recommendation. While the Secretariat has provided some tools and support to small entities, it has to yet develop a capacity for providing internal audit services to small entities.

1.73 **Recommendation.** The Treasury Board Secretariat, in consultation with small entities, should develop a risk-based strategy and establish, within government, a capacity for providing internal audit services to small entities.

The Secretariat's response. Agreed. The Secretariat is currently developing proposals to establish a capacity to provide internal audit services to small entities.

Audit reports

1.74 An audit report is the end product of an internal audit and has two important purposes:

- First, it informs senior management of the findings or results of an audit.
- Second, it provides a basis for program managers to deal with problems identified by the internal auditor.

1.75 The Institute of Internal Auditors has published detailed standards for communicating the results of internal audits. Internal auditors are encouraged to report that their activities are "conducted in accordance with the *International Standards for the Professional Practice of Internal Auditing*." The Treasury Board Policy on Internal Audit also contains standards for internal audit reports. It is important that audit reports communicate the results of an audit and contain a statement of assurance. This statement informs the reader of the quality and rigour of the auditors' work and the sufficiency and quality of the evidence supporting the findings and conclusions.

Access to information needs to be addressed

1.76 Nearly all the internal audit managers and entity senior officials that we met indicated that internal auditing is affected by access to information laws and policies. The requirement to make the results of an audit available to the public affects the timing of the audit, the issues addressed, and how the results are reported. While the managers we interviewed supported the current practice of posting completed internal audit reports on departmental Web sites, they did express concern over providing draft reports and supporting working papers. Similar concerns were raised at the time of our 1996 government-wide assessment of internal audit.

1.77 In 2000 the government established the Task Force on Access to Information to review access to information legislation. The task force recommended that Section 22 of the *Access to Information Act* be amended so that the head of a government institution would not have to disclose draft internal audit reports and supporting working papers until the earliest of the following:

- the date the report is completed,
- six months after the audit is completed, or
- two years after the internal audit began.

1.78 To date, the government has not acted upon the recommendations of its task force. While posting completed internal audit reports on departmental Web sites is appropriate, we are concerned that access to audit working papers may impair the ability of audit groups to discharge their duties.

1.79 **Recommendation.** The Treasury Board Secretariat should take action to deal with the impact of access to information on internal audit groups.

The Secretariat's response. The Secretariat fully supports the principle of full access to all completed internal audit reports. However, the Secretariat also agrees with the Auditor General's concern about the unintended impact of access to information on the ability of internal auditors to discharge their duties. The Public Accounts Committee also considered the impact of access on internal audit to be an important issue (Seventh Report 2001–02).

The Secretariat agrees that action is necessary to deal with the matter and will pursue opportunities to seek the same protection for internal audit as is available to the Office of the Auditor General.

Audit reports are not timely

1.80 To be useful, audit reports should be completed without delay and be easily accessible to the public in a timely manner. To make the reports easily accessible, most departments are posting internal audit reports on their Web sites. In our view, the reporting process takes too long.

1.81 The total time it takes from the planning phase of an audit to the release of the final report and its posting on the Web site ranges from 11 to 24 months (Exhibit 1.8). The delays occur in the reporting phase of the audit, as this stage involves a departmental review of the report before it is released.

Exhibit 1.8 Time it takes from planning phase to release of final audit report

Organization	Planning phase to draft audit report (months)	Draft audit report to audit committee approval (months)	Audit committee approval to posting on Web site (months)	Total (months)
Canadian International Development Agency	10	7	7	24
Foreign Affairs and International Trade	5	7	4	16
Human Resources Development Canada	7	7	2	16
Natural Resources Canada	4	6	4	14
Public Works and Government Services Canada	7	3	1	11
Royal Canadian Mounted Police	10	4	6	20

Source: Departmental records

The Secretariat and its Centre of Excellence for Internal Audit

1.82 The expectations for the Secretariat's Centre of Excellence for Internal Audit are set out in the Treasury Board Policy on Internal Audit. It requires the Centre of Excellence for Internal Audit to do a number of things:

- provide advice to deputy heads, heads of internal audit, and internal audit practitioners on the implementation of the Policy, the development of departmental internal audit policies, annual audit plans, and the application of professional standards;
- establish an active monitoring process that provides timely information to the Treasury Board on significant issues of risk, control, or other problems with management practices in departments;
- develop a human resource strategy for the internal audit community to support departments in implementing the Policy;
- establish a framework to guide a formal evaluation, within five years, of the effectiveness of the Policy; and
- provide assistance to departments in evaluating the performance of their internal audit functions.

1.83 We assessed the progress that the Centre of Excellence for Internal Audit had made in each of these areas.

1.84 The Centre has expended considerable effort to work with the internal audit community to develop tools and guidance and to sponsor workshops and courses to improve internal audit practice. However, the internal audit community expects more leadership from the Centre. It wants the Centre to assume an advocacy role for internal audit, to provide more guidance and direction on government priorities and community-wide issues, to educate senior management on the role and value of internal audit, and to provide more timely tools and advice to the community. In our interviews, many did not believe that the Centre met their needs in providing guidance to the community and timely information on government-wide issues.

1.85 The Centre of Excellence for Internal Audit carries out its monitoring role by holding discussions with heads of internal audit, reviewing and analyzing internal audit plans and reports, and by visiting departmental internal audit groups. In assessing the nature and extent of monitoring by the Secretariat, we found that the Centre had reviewed the audit plans and reports that departments had submitted, as required by the Policy on Internal Audit. However, the Centre does not compare the number of audits planned with the number of reports submitted. This step is essential to ensuring that departments have carried out their audit plans and provided all reports to the Centre.

1.86 Under the Policy on Internal Audit, the Centre is responsible for providing advice to the internal audit community and establishing an active monitoring process that provides timely information to Treasury Board. An important aspect of these responsibilities is the review and analysis of all internal audit reports. This allows the Centre to detect emerging weaknesses in departments that the documents might bring to light. However, because departments do not consistently submit their reports to the Centre and the

Centre does not compare planned audits with the number of reports it receives, it does not know the extent of the weaknesses. If departments do not submit their reports for review and analysis, the Centre cannot detect the emerging weaknesses identified in the audit reports and alert departments and their auditors to these problems. Accordingly, the government may be deprived of valuable information that could help in reducing risk and improving management practices in departments and agencies. For those reports that the Centre analyzed, the analysis was complete and the results were shared with the internal audit community and with the Secretariat.

1.87 **Recommendation.** The Treasury Board Secretariat should ensure that it receives all departmental internal audit reports so that they can be analyzed for emerging weaknesses and that it shares the analysis with the internal audit community.

The Secretariat's response. The Secretariat will work closely with departments to ensure they provide copies of all completed audit reports to the Secretariat in a timely manner, as required by the Policy on Internal Audit.

1.88 The Policy on Internal Audit states that an internal audit advisory committee consisting of government and private-sector senior executives will be established. The committee will advise the Secretariat on internal audit policy, standards, community development strategies, and benchmarks to be used in examining government-wide performance in meeting the objectives of the Policy. At the time of our audit, an advisory committee had not been established.

1.89 A key requirement established for the Centre was to develop a human resource strategy for the community. We noted that a strategy had been developed in 2002. However, in our interviews, many heads of audit and members of the internal audit community noted that the Centre has not resolved a number of critical, strategic human resource management issues. These include determining the classification category for internal auditors, and most importantly, determining the appropriate number of internal audit staff.

1.90 In 2001, the Secretariat published an evaluation framework for assessing whether the Policy on Internal Audit had achieved its stated policy objectives. The framework recommended a two-phase evaluation. The first phase was completed in 2002. We saw some evidence of an action plan to address some of the issues identified in this evaluation; however, the action plan developed was not comprehensive. The second phase requires a comprehensive evaluation within five years of the implementation of the revised Policy on Internal Audit. Secretariat officials have indicated that the comprehensive evaluation will not be carried out until the new Comptroller General has reviewed the state of internal audit in the federal government.

1.91 A key requirement of the revised *International Standards for the Professional Practice of Internal Auditing* is for internal audit groups to conduct an external quality assessment to see if they conform to the standards, at least once every five years. The revised standards require that this assessment be conducted no later than 1 January 2007. We are concerned that the Secretariat has not yet developed a plan for enabling departments and agencies to meet this requirement.

1.92 **Recommendation.** Departments should ensure that their internal audit groups conduct an external quality assessment by 1 January 2007.

The Secretariat's response. The Secretariat has already alerted departments to the requirement of the *International Standards for the Professional Practice of Internal Auditing* for external quality assessments. The Secretariat will work with departments to ensure that they meet this requirement.

1.93 **Recommendation.** The Treasury Board Secretariat should, in its performance report, report progress made in meeting the objectives of the Policy on Internal Audit. This should include reporting the results of departmental quality assessments.

The Secretariat's response. The Secretariat proposes to monitor the performance of internal audit in departments by assessing a number of departmental internal audit functions each year and by conducting a government-wide evaluation of the implementation of Treasury Board's Policy on Internal Audit periodically. The results of these activities will be incorporated in the Treasury Board Secretariat's reporting.

1.94 The Centre of Excellence for Internal Audit has developed a tool for reviewing the content and assessing the extent to which internal audit plans and reports meet the requirements of the Policy on Internal Audit. But, it has not yet developed tools for assessing other components of the Policy. The Centre has shared the results of its analysis of internal audit plans and reports with the internal audit community. However, as noted earlier, not all internal audit reports are provided to the Secretariat.

1.95 While the Centre has a number of initiatives in progress to assist the internal audit community, it generally does not have the community's confidence. The community has developed its own approaches to developing methodologies and sharing practices among its members. Many heads of internal audit commented on the absence of strategic leadership from the Centre. In particular, a number of departmental internal audit groups have developed strategies for working collaboratively among themselves to resolve issues. This exercise involves dedicating resources and contract funds to address such issues as quality assurance reviews, benchmarks for internal audit, and developing methodologies. Such activity reflects, in our opinion, a lack of confidence in the Centre to resolve key issues facing the internal audit community.

1.96 Overall, the Centre is not adequately discharging its obligation under the Policy on Internal Audit. Why has it not provided leadership? The Centre's staff suggested a number of reasons. They told us that funding for the Centre was uncertain. This has led the Centre to cut back or eliminate key activities such as the Heads of Internal Audit Conference and makes it difficult for the Centre to attract and retain staff and develop any long-range plans.

1.97 To assess this, we reviewed the budget for the Centre. In 2001–02, the Centre spent $1,488,203 of its $1,563,255 operating and maintenance budget; in 2002–03, it spent $1,291,661 of its $1,342,000 budget. For 2003–04, the Centre's approved operating and maintenance budget was $627,347—it only received $136,100. The remaining $491,247 was shifted to other areas of the Secretariat. At the time of our audit, the 2004–05 budget for the Centre had not been approved.

1.98 The effectiveness of the Centre has been affected by frequent changes in leadership. Since 2000, it has had five executive directors and five deputy comptrollers general, until the appointment of the new Comptroller General in 2004. The Centre's Executive Director reports to this position. This turnover has meant that sustained, committed leadership at the Centre has been lacking.

1.99 **Recommendation.** The Treasury Board Secretariat should evaluate the Centre of Excellence for Internal Audit's capacity to meet the responsibilities established for it by the Policy on Internal Audit and take actions to address any gaps in their capacity.

The Secretariat's response. Agreed. The Secretariat recognizes that it has to take on a stronger role. There is now underway a thorough analysis of the role that the Secretariat should play in the overall government internal audit regime and of the capacity that will be required to deliver.

1.100 Effective 1 June 2004 the government re-established the Office of the Comptroller General to strengthen comptrollership and oversight across the federal government. The Comptroller General's key duties include setting or reviewing the auditing standards and policies of the Government of Canada, providing leadership to ensure and enforce appropriate financial controls, and promoting sound resource stewardship at all levels across the federal government. This will necessitate taking clear steps to strengthen internal audit within the Canadian federal government.

Conclusion

1.101 While investments have been made and steps taken to strengthen the internal audit community within the federal government, considerable work remains to be done if the government is to achieve the objectives established in the Policy on Internal Audit. The effectiveness of internal audit varies considerably within the federal government. It is dependent upon the nature and extent of departmental senior management's understanding of the role that internal audit can and should play within an organization and the level of support that senior management provides. The success of internal audit depends upon the professionalism of the internal audit activity and the value that it adds to the department. Both are fundamental prerequisites.

1.102 On a government-wide basis the Treasury Board Secretariat's Centre of Excellence for Internal Audit must establish a clear strategic direction for government departments and the internal audit community. As well, the

Centre must develop the necessary capacity if it is to effectively meet its responsibilities as established by the Policy on Internal Audit. Achieving these objectives will require consistent execution of the Centre's mandate, and consistent, stable funding and support for the mandate from the Secretariat's senior management.

The Secretariat's response. The Treasury Board of Canada introduced a new Policy on Internal Audit in April 2001 aimed at repositioning internal audit in the public service as a provider of assurance services to departmental management. Good progress has been made, but it was always anticipated that full implementation would take several years. The report on internal audit in departments and agencies highlights a number of opportunities for improvement. The Secretariat agrees that improvement is required.

Early this year the government announced a number of initiatives to strengthen comptrollership in the public service, including the re-establishment of the Comptroller General within the Treasury Board Secretariat. In this context, the government signaled its commitment to strengthening internal audit across the public service and has directed Treasury Board Secretariat to establish a more effective government internal audit function. As a result, the Comptroller General is currently developing proposals that are aimed at ensuring that the Canadian public service has a high performance internal audit regime. These proposals include

- strengthening internal audit capacity across the public service in terms of both resources and skills;
- a more structured role for departmental audit committees, and measures to enhance the independence and qualifications of audit committee members;
- defining the role of the departmental head of audit and emphasizing the need for independence and professionalism in that role;
- new roles for the Comptroller General in carrying out cross-departmental internal audits and supporting internal audits in small departments and agencies; and
- strengthened roles for the Comptroller General in monitoring and supporting internal audit performance in departments, including the introduction of uniform, proven operating processes for internal auditing in all departments.

These proposals address many recommendations directly. The Policy on Internal Audit will be amended to the extent necessary to implement them. Implementation will be a multi-year initiative, requiring a carefully planned transition and monitoring of results.

About the Audit

Objectives

The objective of the audit was to assess whether departmental internal audit groups and the Treasury Board Secretariat's Centre of Excellence for Internal Audit met the objectives set out for them in the Policy on Internal Audit.

The audit also considered the nature and extent of the Secretariat's active monitoring and the completeness of its human resource strategy for the internal audit community.

Scope and approach

To assess the compliance of departmental internal audit groups, we conducted quality assessments in a sample of departments and agencies to determine whether the objectives of the Policy, which incorporate the Institute of Internal Auditors' *International Standards for the Professional Practice of Internal Auditing*, were being met. We assessed the work of the internal audit groups that was completed after the introduction of the revised Policy.

The organizations selected for a detailed quality assessment were

- the Canadian International Development Agency,
- Foreign Affairs and International Trade (on 12 December 2003, this Department was divided into two departments—Foreign Affairs Canada and International Trade Canada),
- Human Resources Development Canada (on 12 December 2003, this Department was divided into two departments—Human Resources and Skills Development Canada and Social Development Canada),
- Natural Resources Canada,
- Public Works and Government Services Canada, and
- the Royal Canadian Mounted Police.

Criteria

The criteria for the audit are based on the Policy on Internal Audit issued by the Treasury Board. The Policy requires that internal audit groups:

- be organizationally independent and staffed with individuals who have an impartial, unbiased attitude and avoid conflicts of interest;
- have the capacity to accomplish its responsibilities, by having sufficient resources and being staffed with competent people, effectively deployed, who work to professional standards; use good communication practices; and adhere to public service and professional ethics, values, and codes of conduct;
- have the breadth of knowledge to accomplish its responsibilities, by using work teams that collectively possess or have access to sufficient expertise of the subject matter being audited;
- be managed effectively with approved plans that address areas of highest risk and significance and provide periodic summary reports to management on the activities and performance of the internal audit function and on any significant risks and control issues;
- conduct individual audits in an effective and efficient manner with risk-based plans that address the scope of the engagement, with work programs that meet the objectives of the engagement, and sufficient appropriate evidence that supports the findings and conclusions;
- prepare clear concise reports on a timely basis so that management can readily focus on and understand the important issues being reported. Reports should provide context for the observations and identify to whom the recommendations are directed;
- ensure that the Treasury Board Secretariat is provided with annual internal audit plans and completed reports; and
- ensure reports are made accessible to the public in an efficient and effective manner.

The Treasury Board's Policy on Internal Audit has adopted the *International Standards for the Professional Practice of Internal Auditing* issued by the Institute of Internal Auditors as its standard. Accordingly, we used the Institute's standards to elaborate and provide detail for the criteria statements.

The criteria for assessing departmental audit committees are similarly based on the requirements of the Policy on Internal Audit. Departmental audit committees should

- strengthen the independence and effectiveness of the internal audit function;
- provide complete, accurate, and timely advice and counsel to the deputy head on the adequacy, design, and operation of management control frameworks, and the quality of financial and other performance information used for decision making and reporting;
- provide the deputy head with adequate information that allows him/her to inform the Treasury Board Secretariat, as necessary, on significant issues of risk, control, or weaknesses in management practices;
- ensure that management action plans incorporate the results of internal audit into the departmental priority setting, planning, and decision-making processes;
- ensure that management action plans, if implemented, are sufficient to address the weaknesses identified in the internal audit report; and
- monitor the performance of the internal audit group to ensure the objectives of the Policy on Internal Audit are met.

The Secretariat, through its Centre of Excellence for Internal Audit should

- monitor progress in departments and agencies on a government-wide basis. Strategic intervention should be exercised as appropriate to support the implementation of the Policy on Internal Audit;
- provide sound professional advice to deputy heads, heads of internal audit, and internal audit practitioners, which will support efforts to implement the Policy on Internal Audit; and
- keep Parliament informed about matters of significance and the progress made in achieving the objectives of the Policy on Internal Audit.

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Report of the Auditor General of Canada to the House of Commons—November 2004

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2004

Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 2

Implementation of the National Initiative to Combat Money Laundering

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, a Message from the Auditor General, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

2

Implementation of the National Initiative to Combat Money Laundering

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Implementation of the National Initiative to Combat Money Laundering

Main Points

2.1 To strengthen its anti-money-laundering strategy, in 2000 Canada introduced the National Initiative to Combat Money Laundering, making it mandatory to report certain financial transactions to the new Financial Transactions and Reports Analysis Centre, or FINTRAC. The mandate of FINTRAC was to analyze these transaction reports and disclose information to police and other authorities to facilitate the investigation and prosecution of money laundering. After September 11, 2001, FINTRAC's mandate was broadened to also apply to the financing of terrorist activities. Canada now has a comprehensive strategy against money laundering and terrorist financing that is generally consistent with international standards. However, a number of factors impede the strategy's performance.

2.2 Legislation limits the information FINTRAC may disclose on suspicious transactions to so-called "tombstone" data: account numbers; names of the account holders; and places, dates, and values of transactions that have occurred. When a disclosure is related to an ongoing investigation, these data can be useful in corroborating findings or providing new leads. Otherwise, law enforcement and security agencies normally find that the information FINTRAC discloses is too limited to warrant action, given their existing caseloads and scarce resources. In short, as the system now works, FINTRAC disclosures can contribute to existing investigations but rarely generate new ones.

2.3 Effective efforts against money-laundering and terrorist-financing activities begin where these activities take place—with the financial institutions and others that handle the illicit funds. FINTRAC has an extensive outreach program to help the parties who are required to report understand their obligations. However, it gives them little feedback on their reports and on trends in money laundering and terrorist financing, feedback that could help them identify suspect transactions and produce better reports. Moreover, policies and procedures to monitor and ensure their compliance with reporting requirements have still not been implemented fully.

2.4 The Initiative involves a partnership among several federal organizations, law enforcement and security agencies, and industry regulators. All of these partners need to work together closely if resources are to be used effectively to detect and deter money-laundering and terrorist-financing activities. We found that while the partners interact regularly, co-operation among them could be improved.

2.5 One area where improved co-operation would help is the development of effective accountability mechanisms for the Initiative. FINTRAC collects and analyzes huge quantities of reports and other information and provides financial intelligence to law enforcement agencies and other authorities. It depends on their feedback to know how they use its disclosures and to what benefit. To date, however, not all recipients track their use of the information disclosed to them by FINTRAC. Without a comprehensive system for monitoring the use of its disclosures, it is impossible for FINTRAC to assess the value of the intelligence it provides and how it can be made better. It is equally impossible to assess the Initiative's performance overall and its impact on money-laundering and terrorist-financing activities in Canada.

2.6 We identified a number of government actions needed to make the Initiative more effective:

- Broaden the kinds of information that FINTRAC may disclose, within limits that respect the privacy rights of Canadians.
- Implement a management framework to provide direction and to strengthen the co-ordination of efforts within the federal government and with stakeholders at other levels of government and in the private sector.
- Establish accountability structures to ensure that the information needed for measuring the Initiative's performance is collected and that results are reported to Parliament regularly.

2.7 Legislation calls for parliamentary review of the Initiative by 5 July 2005. The parliamentary committee conducting that review may wish to look at these issues and at whether lawyers are still exempt from the anti-money-laundering legislation, as they have been since March 2003 following successful legal challenges.

The government has responded. FINTRAC, the Department of Finance Canada, and the Canada Revenue Agency are in general agreement with our recommendations. Their respective responses are included in full throughout the chapter.

Introduction

2.8 During the 1990s, the Paris-based Financial Action Task Force on Money Laundering, the international standard-setting body for efforts against money laundering, criticized Canada's anti-money-laundering strategy. Specifically, it criticized Canada for relying on the voluntary reporting of suspicious transactions and for lacking a central financial intelligence unit to receive, analyze, and disclose information related to money laundering.

2.9 The National Initiative to Combat Money Laundering, introduced in 2000, was designed in part to respond to these criticisms. Legislation adopted that year, the *Proceeds of Crime (Money Laundering)* Act, created a system for the mandatory reporting of suspicious financial transactions, cross-border transfers of large amounts of currency, and certain prescribed transactions. (Exhibit 2.1 indicates the types of parties and information to which the reporting requirements apply.) The legislation also established an agency, the Financial Transactions and Reports Analysis Centre of Canada (FINTRAC), to collect and analyze these financial transaction reports and disclose pertinent information to the police and other authorities in order to help them investigate and prosecute money laundering.

Exhibit 2.1 Canada's anti-money-laundering reporting regime

Who must report

- Deposit-taking institutions
- Life insurance companies, brokers, or agents
- Securities dealers, portfolio managers, and investment counsellors
- Money services businesses
- Foreign exchange dealers
- Accountants and real estate agents, when carrying out certain activities for their clients
- Casinos
- Individuals or entities transferring large amounts of currency or monetary instruments into or out of Canada

What they must report

- Suspicious transactions on money laundering or terrorist financing
- Possession or control of terrorist-owned property
- International electronic fund transfers of $10,000 or more
- Cash transactions of $10,000 or more
- Cross-border currency transfers of $10,000 or more
- Customs seizure reports

Source: FINTRAC

2.10 After the terrorist attacks of September 11, 2001, Parliament broadened the scope of the anti-money-laundering legislation to also apply to the financing of terrorist activities. The *Proceeds of Crime (Money Laundering) Act* became the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*. The new act expanded reporting requirements to include the reporting of suspected terrorist-financing activities, and broadened FINTRAC's mandate to the detection, deterrence, and prevention of terrorist financing as well as money laundering.

2.11 Several government departments and agencies besides FINTRAC are directly involved in implementing the government's anti-money-laundering Initiative:

- The Department of Finance Canada is responsible for evaluating the Initiative, developing policies, and co-ordinating Canada's participation in international efforts against money laundering and terrorist financing.
- The Canada Border Services Agency administers the requirements for reporting cross-border transfers of currency or other monetary instruments, such as travellers' cheques, stocks, and bonds.
- The RCMP, the Canadian Security Intelligence Service (CSIS), and the Canada Revenue Agency receive and act upon information disclosures from FINTRAC.
- The Department of Justice Canada prosecutes money-laundering and terrorist-financing offences.
- Public Safety and Emergency Preparedness Canada has a leadership role under the National Agenda to Combat Organized Crime, which identifies money laundering as a national priority; a role in the accountability of other partners in the Initiative (namely, the Canada Border Services Agency, CSIS, and the RCMP); and a role in co-ordinating the development of policies to counter terrorist financing.

2.12 Exhibit 2.2 shows the resources allotted to the various partners for Initiative activities over the past four years; at the end of March 2004 they had spent a total of $140.1 million. FINTRAC received an additional $34.2 million over this period for its expanded mandate to detect and deter terrorist financing. Currently, the ongoing administrative costs of the Initiative and of FINTRAC's terrorist financing mandate total roughly $45 million a year. Reporting entities also spend considerable sums on compliance.

Focus of the audit

2.13 The Auditor General's April 2003 Report, Chapter 3, Canada's Strategy to Combat Money Laundering, set out the background to the government's anti-money-laundering strategy and the challenges it had to meet to be effective. This chapter reports on the results of changes to that strategy introduced in 2000 with the National Initiative to Combat Money Laundering.

2.14 The objective of the audit was to determine whether the management framework for implementing the Initiative

- is designed appropriately to promote the detection and deterrence of money laundering and terrorist financing, and
- provides accountability to Parliament for results achieved.

2.15 As FINTRAC and the new reporting requirements were the key elements in the Initiative, our audit focussed primarily on FINTRAC's operations. We also examined the anti-money-laundering activities of other partners in the Initiative, and especially their relationship to FINTRAC, which is key to how well the Initiative works and what it can achieve.

2.16 Legislation calls for a parliamentary committee to review the Initiative by 5 July 2005. We believe that the issues raised in our audit will be of interest to that committee and that it may find them useful in its review.

2.17 Further details on our audit objectives, scope, approach, and criteria are presented in **About the Audit** at the end of the chapter.

Exhibit 2.2 Spending on the National Initiative to Combat Money Laundering ($ millions)

Department	2000-01	2001-02	2002-03	2003-04	Total
FINTRAC[1]	18.0	25.5	26.3	22.2	92.0
Canada Revenue Agency and Canada Border Services Agency	5.3	6.0	6.0	6.0	23.3
RCMP	2.6	4.9	4.9	4.9	17.3
Justice Canada	0.6	1.2	1.2	1.2	4.2
Citizenship and Immigration Canada[2]	0.0	0.7	0.7	0.7	2.1
Finance Canada	0.3	0.3	0.3	0.3	1.2
Total	**26.8**	**38.6**	**39.4**	**35.3**	**140.1**

[1] Also received $10 million in 2001-02, $14.7 million in 2002-03, and $9.5 million in 2003-04 for its expanded mandate to detect and deter terrorist financing.

[2] Activities funded under the Initiative were integrated into the Canada Border Services Agency with the reorganization of government departments (December 2003).

Source: Finance Canada and FINTRAC

Observations and Recommendations

Institutional framework

Canada has a comprehensive anti-money-laundering system that is generally consistent with international standards

2.18 With the introduction of the Initiative, Canada now has in place most of the elements that the Financial Action Task Force on Money Laundering has recommended for an effective anti-money-laundering system. Canadian law makes money laundering a crime, based on a wide range of underlying offences. In addition, Canada has reporting requirements with broad application, and a financial intelligence unit with important advantages over counterparts in other countries:

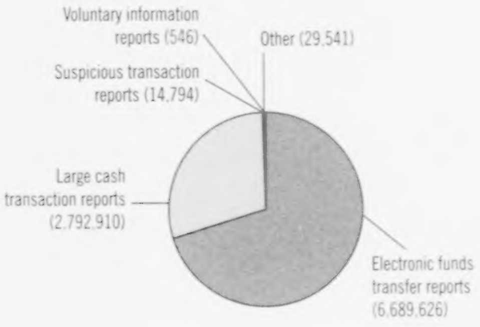
- A broad range of transactions must be reported to FINTRAC, including international electronic funds transfers in addition to large cash and suspicious transactions. Few other financial intelligence units receive reports on electronic funds transfers.
- Electronic reporting is required where it is possible; more than 99 percent of reports received by FINTRAC are filed electronically.
- In staff and resources, FINTRAC is among the largest financial intelligence units in the world.

2.19 At the same time, FINTRAC's operations and its capacity to provide financial intelligence to law enforcement are limited by a strict legislative framework designed to protect the privacy of the information FINTRAC receives. A key feature of that framework is FINTRAC's status as an independent agency that operates at arm's length from law enforcement. In addition, the conditions under which FINTRAC may disclose information and the information that it may disclose are set out specifically in legislation. These safeguards are unusual: most other countries allow much closer links and easier flow of information between their financial intelligence units and law enforcement.

2.20 In the four years since it was created, FINTRAC has invested heavily in computer technology and employee training to meet its objective of producing high-quality financial intelligence. It has devoted considerable effort to building relationships and developing policies to support the government's strategy against money laundering and terrorist financing. In this relatively short period, FINTRAC has established itself as a key player in that strategy, though it does not yet have all capabilities fully in place.

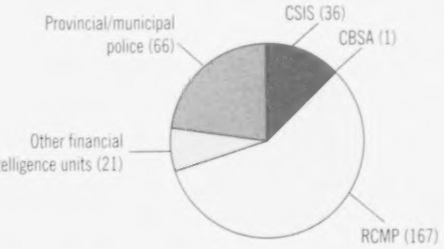
2.21 FINTRAC now receives some 10 million transaction reports a year (Exhibit 2.3). It analyzes these reports, together with other information it may collect, and it discloses designated information when it has "reasonable grounds" to suspect that the information may be relevant to the investigation or prosecution of money laundering or terrorist financing. In 2003–04, it made 197 disclosures to law enforcement and other agencies, up from 103 the year before. About one quarter of its disclosures were related to suspected terrorist financing and the rest to suspected money laundering. Exhibit 2.4 shows the distribution of FINTRAC disclosures by recipient agency.

Exhibit 2.3 FINTRAC received 9.5 million transaction reports in 2003–04



Source: FINTRAC

Exhibit 2.4 The distribution of FINTRAC disclosures in 2003–04, by agency



The total was 197 disclosures, but many disclosures were provided to more than one agency.

Source: FINTRAC

2.22 The impact of these disclosures is hard to assess adequately, owing in part to incomplete follow-up on how they are used. Officials from law enforcement and security agencies told us that FINTRAC disclosures contributed new intelligence to ongoing investigations but rarely led to new investigations. Investigations into money laundering and terrorist financing can be complex and lengthy. At the time of our audit, no prosecutions had been launched yet as a result of FINTRAC disclosures.

Success hinges on co-operation among many partners

2.23 The success of the Initiative depends on co-operation among not only the several federal departments and agencies involved as partners but also provincial and municipal law enforcement agencies and regulatory authorities, the financial sector, and others who are required to report. All of these partners and stakeholders need to work together closely if resources are to be used effectively to detect and deter money laundering and terrorist financing.

2.24 Federal partners in the Initiative interact regularly with each other and with external stakeholders. FINTRAC, in particular, has an ambitious outreach program and consults extensively with law enforcement agencies and reporting entities to explain what it does and to obtain feedback on its disclosures. The federal partners interact primarily through an interdepartmental working group led by Finance Canada. The group meets regularly and, although no minutes are kept, participants we interviewed said that it provides an effective means of discussing common issues. Interdepartmental meetings of officials at the assistant deputy minister level also take place from time to time and provide another forum for discussing Initiative issues.

2.25 Nevertheless, at the operational level we found signs of friction, such as the following:

- Despite the significant outreach efforts by FINTRAC over the past three years, police forces still are sometimes reluctant to share information with it and do not give much weight to unsolicited disclosures by FINTRAC.
- Connectivity problems between the information technology systems of FINTRAC and the Canada Border Services Agency have led to a large backlog of unprocessed reports on cross-border currency transfers.
- FINTRAC and the Canada Revenue Agency have yet to agree on criteria for identifying money-laundering transactions that could also be related to tax evasion.
- Some reporting entities told us that regulatory requirements are often announced or imposed on them without adequate appreciation of the difficulties and costs of compliance.

2.26 In an initiative with so many players, relationship problems are not surprising. Moreover, the anti-money laundering initiative is relatively new, and many of these problems could reflect inevitable growing pains. It takes time to establish effective networks for co-operation and to build the trust on which co-operation depends.

2.27 We believe that to support that process, more effective mechanisms and leadership are needed for co-ordinating efforts both within the federal government and among all stakeholders. At the federal level, the interdepartmental working group chaired by Finance Canada lacks the scope and mandate for effective support of a co-ordinated campaign against money laundering and terrorist financing. The meetings of officials at the assistant deputy minister level lack effective procedures for resolving interdepartmental disputes and ensuring accountability for results. We found, as we had in our audit of the anti-terrorism measures of 2001, that the government did not have a management framework to direct complementary actions in separate agencies.

2.28 The Initiative would also benefit from mechanisms that would bring in provincial and private sector stakeholders. Faced with a similar challenge, the United States and the United Kingdom have established anti-money-laundering advisory committees with representatives of law enforcement, government, and industry. These committees meet regularly to consider emerging issues and develop approaches to dealing with them. They have proved useful in those countries, and such committees could help here as well.

2.29 **Recommendation.** The government should establish an effective management framework to provide direction and co-ordinate anti-money-laundering efforts at the federal level. It should also consider establishing an anti-money-laundering advisory committee with representatives of government, industry, and law enforcement to regularly discuss issues of common interest and develop approaches for dealing with emerging issues.

Finance Canada's response. As noted in the chapter, the Department of Finance chairs the current interdepartmental group at the assistant deputy minister level and its working-level extension. While these forums have been successful in co-ordinating initiative-wide efforts, reporting the results of these efforts, and discussing and resolving common issues, the Department of Finance will examine the roles of these interdepartmental groups and make any improvements or changes as required.

As well, the Department of Finance will review international best practices (including the UK and U.S. models) in considering the merits of establishing a formal advisory committee for the overall Initiative with broad representation from government, industry, and law enforcement.

Exemption of lawyers leaves a gap in coverage

2.30 Initial anti-money-laundering regulations included lawyers and legal firms among the entities required to report suspicious financial transactions. But legal service providers were exempted from the regulations in March 2003, following successful court challenges by lawyers on the grounds that reporting requirements violated lawyer-client privilege. This exemption is widely regarded as a serious gap in the coverage of the anti-money-laundering legislation. It means that individuals can now do banking through a lawyer without having their identity revealed, bypassing a key component of the anti-money-laundering system.

2.31 In a 2001 report on money-laundering trends, the Financial Action Task Force on Money Laundering (FATF) drew attention to the growing use of channels outside the financial sector to launder funds. It noted specifically that "lawyers, notaries, accountants and other professionals offering financial advice have become the common elements to complex money laundering schemes. This trend is mentioned by almost all FATF members." In response to these trends, the Task Force revised its "Forty Recommendations" in June 2003 to broaden the range of reporting entities covered, including notably lawyers, notaries, and other independent legal professionals.

2.32 The Task Force's recommendations are widely accepted as the international standard in national anti-money-laundering measures. The removal of lawyers from the reporting requirements of the legislation in Canada means that our anti-money-laundering system does not fully meet international standards, yet meeting them was one of the objectives of the National Initiative to Combat Money Laundering.

2.33 Over the past 15 months, Finance Canada and Canadian law societies have been discussing options for bringing the legal profession back within the coverage of the legislation's reporting requirements without compromising lawyer-client privilege.

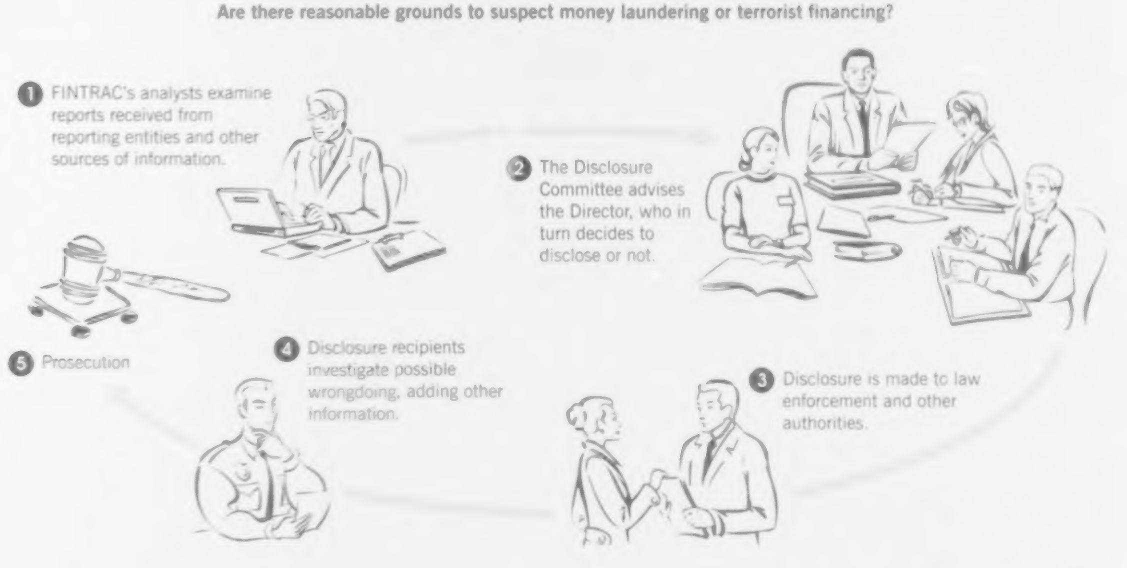
Disclosure of financial intelligence

No written criteria are used in deciding which cases to disclose

2.34 FINTRAC analysts review reports the agency receives, looking for links to money laundering or terrorist financing. They search FINTRAC's database for information linking a report to a broader pattern of financial transactions, and they match this information with information from other sources, including law enforcement and commercial databases and open-source electronic and print media. When the analysis reveals "reasonable grounds to suspect" that a transaction is related to money laundering or terrorist financing, the analyst recommends to FINTRAC's Disclosure Committee that a disclosure be made. The Committee, in turn, advises the Director, who makes the final decision (Exhibit 2.5).

2.35 Analysts use a wide variety of indicators from a number of sources to determine whether a transaction is related to money laundering or terrorist financing. These include indicators and typologies issued by the Financial Action Task Force on Money Laundering, as well as anti-money-laundering guidelines issued by a number of financial intelligence units to their reporting

Exhibit 2.5 How FINTRAC reports contribute intelligence for investigation and prosecution


Are there reasonable grounds to suspect money laundering or terrorist financing?
❶ FINTRAC's analysts examine reports received from reporting entities and other sources of information.
❷ The Disclosure Committee advises the Director, who in turn decides to disclose or not.
❸ Disclosure is made to law enforcement and other authorities.
❹ Disclosure recipients investigate possible wrongdoing, adding other information.
❺ Prosecution

entities. But FINTRAC has no set of written criteria to guide its analysts in determining when a threshold for disclosure has been met or to help the Disclosure Committee and the Director decide whether to disclose a case.

2.36 While it will always take a certain level of judgment to decide what constitutes "reasonable grounds" for suspicion, an explicit framework would help produce consistent decisions among analysts and over time. If developed with the assistance of law enforcement and security agencies and shared with them, a framework would also help improve their understanding of FINTRAC's disclosure threshold and increase their confidence in the value of the disclosures they receive from FINTRAC.

2.37 **Recommendation.** In co-operation with law enforcement and security agencies, FINTRAC should establish a set of written criteria to guide its analysts and its Disclosure Committee in determining which transactions to disclose.

FINTRAC's response. FINTRAC continually seeks to refine and improve the tools it uses for its analytical function. A reference guide of indicators was developed with the assistance of work done by the Financial Action Task Force and the Egmont Group of financial intelligence units. These internationally recognized indicators have been developed with input from law enforcement. In addition, FINTRAC, with law enforcement and security agency representatives, will review the current guide of indicators to ensure that they meet the requirements of the Canadian context. As noted in the chapter, the analysis and disclosure processes will continue to rely heavily on judgment, as each suspected case of money laundering, terrorist activity financing, or threat to the security of Canada must be assessed on its own merit.

Restrictions on the information that may be disclosed limit the value of disclosures

2.38 The *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* permits disclosure of "designated information" when it passes the threshold for "reasonable grounds to suspect" that the information would be relevant to investigating money laundering or terrorist financing. "Designated information" under the Act includes a transaction's date and place, its value, and the associated account numbers and names of the parties involved—so-called "tombstone" information.

2.39 When a disclosure is related to an ongoing investigation, it can contribute much useful support by providing new leads and helping to "chase the money," as one law enforcement officer put it. Otherwise, law enforcement and security agencies generally find that the information FINTRAC discloses is too limited to warrant action. Police forces in large urban centres, in particular, are already too swamped by their own investigations to take on new cases based on FINTRAC disclosures. Unless they concern an ongoing case, most disclosures are simply added to the recipient police force's database as possible future intelligence.

2.40 Law enforcement officers told us that suspicious-transaction reports they receive directly from banks often contain more useful information than

FINTRAC disclosures—they are more current and provide the reasons for suspicion. This is a serious criticism of a system set up expressly to add value to the raw information provided by reporting entities.

2.41 Finance Canada chairs a working group—which includes FINTRAC and law enforcement—that is exploring the possibility of adding telephone numbers, publicly available information such as names of a company's directors, and other information to FINTRAC disclosures to make them more useful. However, what the disclosures lack most is context: What led FINTRAC to suspect the presence of money laundering or terrorist financing? Without that context, law enforcement agencies are reluctant to devote scarce resources to an investigation that could lead to a dead end.

2.42 Legislation provides that law enforcement and security agencies who want more information from FINTRAC may apply to a judge for a "production order" to access additional details on transactions and the analysis supporting the disclosure. Only two such requests have been submitted to date; both were granted.

2.43 Law enforcement and security officers we interviewed cited two basic reasons for the reluctance to apply for production orders. One is that the legislative threshold is high, the same as for a search warrant: the applicant must satisfy the court that there are "reasonable grounds to believe" an offence has been committed. A search warrant is preferable because FINTRAC provides only intelligence, whereas a search warrant provides direct access to a target and to information that could be used as evidence. Moreover, the information contained in FINTRAC disclosures is generally considered below the legislative threshold that a production order requires.

2.44 Disclosures are hand-delivered to recipients, in part for security reasons; this also gives FINTRAC liaison officers more opportunity to develop contacts with law enforcement and security agencies, explain FINTRAC's mandate, and get feedback. In practice, though, this opportunity is severely limited by procedures that strictly prohibit the liaison officer from discussing any details of the disclosure beyond what is in the delivery package or venturing an opinion on what led FINTRAC to believe there are reasonable grounds to suspect that the information is relevant to money laundering or terrorist financing.

2.45 The law enforcement and security officers we talked to all appreciated the need to safeguard privacy rights, but several thought FINTRAC's interpretation of "designated information" might be excessively restrictive. The intent of the legislation is to protect privacy rights by prohibiting disclosure of information unrelated to a suspicious activity—but should disclosure of information on what makes an activity suspect also be prohibited? As long as FINTRAC continues using that interpretation, the value of its disclosures to law enforcement will remain limited.

2.46 **Recommendation.** The government should carry out a review to identify changes that would improve the value of FINTRAC disclosures and the means to bring about those changes.

Finance Canada's response. As noted in the chapter, the Department of Finance is chairing a working group of several Initiative partners to examine ways to improve the effectiveness of FINTRAC's disclosures.

The working group may identify possible operational improvements that could be made. Should there be proposed legislative amendments, the Department of Finance would look to the upcoming legislative reviews of Bills C-36 and C-22 as the appropriate venues for parliamentarians to consider recommended changes.

More needs to be done to encourage submission of voluntary information reports

2.47 Voluntary information reports from law enforcement and security agencies are an important source of intelligence for FINTRAC, and the agency promotes such reporting. Its liaison officers are instructed, when delivering disclosures, to advise recipients of the value of voluntary information reports to FINTRAC's analysis and its ability to determine that there are reasonable grounds to suspect money laundering or terrorist financing.

2.48 Indeed, though voluntary information reports make up only about two percent of the total of suspicious transaction and voluntary information reports, they contribute to two thirds of the disclosures FINTRAC makes. And those are the disclosures that law enforcement and security agencies find are most useful to their investigations and save them valuable time in confirming findings.

2.49 Yet law enforcement agencies are often reluctant to submit voluntary information reports because they are uncertain how FINTRAC will use the information. One agency told us that it hesitates to give FINTRAC information on ongoing investigations, out of concern that the investigations could be compromised. Another told us that it tends to submit voluntary information reports toward the end of an investigation, when it is about to close a file for lack of sufficient evidence. A third said that it does not submit voluntary information reports because it expects little back from FINTRAC.

2.50 Indeed, in most cases a law enforcement or intelligence agency submitting a voluntary information report hears nothing further from FINTRAC, due to the legislative restrictions on the information it can share. Of 713 voluntary information reports submitted to FINTRAC to the end of March 2004, 113 had resulted in return disclosures. In the remaining 600 cases, the agency submitting the report had no way of knowing whether FINTRAC was still working on the case or lacked meaningful additional intelligence to meet its threshold for disclosure. Unless FINTRAC has information that does meet its disclosure threshold, it simply sends nothing back. Its position is that outside of "designated information" determined to be relevant to money laundering or terrorist financing, the law prohibits any communication about the voluntary information report—not even an acknowledgement of receipt.

2.51 To a law enforcement or security agency, this situation is clearly unsatisfactory. It would like to know whether FINTRAC is working on a report that it submitted and, if so, when it might expect a related disclosure. Such knowledge would minimize the possibility of closing a case prematurely on the assumption that FINTRAC had nothing to report. Or it could help the agency decide to terminate a case rather than wait for information that FINTRAC is not going to provide. In either case, valuable police time and resources would be saved. As the law now reads, however, FINTRAC is apparently prevented from communicating the status of a voluntary information report to the agency that submitted it.

2.52 In our view, even within the existing legislative framework the voluntary information report process can be made more transparent and useful. It should be possible for FINTRAC to establish target turnaround times for voluntary information reports it receives and to make those targets public. Currently, it has no such timeline targets, even though one of its stated objectives is the delivery of timely financial intelligence. Explicit, publicly reported targets would reduce the present uncertainty for law enforcement and security agencies and could also motivate FINTRAC to return information in a shorter period of time than it often takes now. Making the voluntary information report process more useful to law enforcement and security agencies would, in turn, encourage them to use it more.

2.53 Law enforcement and security agencies would also be encouraged to submit more voluntary information reports if FINTRAC used a standard electronic format, as it does for suspicious-transaction reports. This is an option that FINTRAC has considered but has not yet adopted.

2.54 **Recommendation.** FINTRAC should establish target turnaround times for voluntary information reports it receives from law enforcement and security agencies and should make those targets public.

FINTRAC's response. FINTRAC will establish target turnaround times by which it will give notice to domestic disclosure recipients (law enforcement, CSIS, and other government agencies) of the status of the voluntary information they have provided.

Limited feedback is provided to reporting entities

2.55 Evaluation and feedback are important means for improving the quality of transaction reports to FINTRAC and hence their usefulness. Effective monitoring of money laundering and terrorist financing therefore begins with the reporting entities—dealing directly with customers and handling transactions puts them in the best position to notice unusual activity and identify suspicious transactions. But they must know how to spot such transactions and report them properly.

2.56 FINTRAC has an extensive outreach program to help the parties who are required to report understand and meet their obligations, but it gives them limited feedback on the reports they provide. Over the past year, it has made presentations to individual banks upon request, providing information on reporting trends and on the contribution the bank's reports have made to FINTRAC disclosures. Publicly available feedback, which could benefit all reporting entities, is limited to the number of reports FINTRAC receives by reporting sector. Representatives of reporting entities we talked to wanted more feedback, and we believe that more can be provided.

2.57 While legislation prevents it from giving feedback on how it has used specific reports, FINTRAC should be able to provide information by sector on the quality of reports, typical reporting errors, and attributes of a good report. It should also be able to provide summary information on how the reports it receives are used and to what benefit. More feedback of this kind could help reporting entities improve the quality of their reports and strengthen their commitment to the reporting process by demonstrating the benefits of the efforts and resources they have invested.

Backlog of reports on cross-border movements of currency limits their intelligence value

2.58 The legislation provides that all cross-border transfers of currency or other monetary instruments valued at $10,000 or more must be reported to a customs officer. Customs inspectors have authority to seize unreported currency. If the money is suspected to be the proceeds of crime, it is "seized as forfeit."

2.59 Customs officers collect these reports and forward them to the Database Section of the Canada Border Services Agency (CBSA) at its headquarters in Ottawa. There they are entered into an automated system using entry fields specified by FINTRAC, and the reports are sent to FINTRAC.

2.60 Reporting of cross-border currency transfers became a requirement on 6 January 2003. According to the CBSA, it had collected over 60,000 reports by the end of March 2004 and made 1,521 currency seizures, totalling more than $46 million. In 224 of those cases, the currency was forfeited as suspected proceeds of crime or funds for terrorist financing, yielding some $17 million to the Crown.

2.61 The Canada Border Services Agency told us that the volume of reports and the resource levels needed to enter data for transmission to FINTRAC are considerably higher than originally anticipated. In addition, incompatible software and security firewalls between the two agencies have led to extended downtime and slow transmission of information. While reports resulting from enforcement actions such as currency seizures are processed on a priority basis, at the time of our audit a nine-month backlog of reports submitted by compliant travellers and businesses awaited data entry at CBSA headquarters in Ottawa.

2.62 FINTRAC and the CBSA are working to resolve the connectivity problems between their information technology systems. Also, in September 2004 the CBSA hired two additional data entry clerks to help eliminate the backlog of unprocessed reports.

2.63 Until the backlog is cleared, potentially valuable intelligence will remain unused in the fight against money laundering and terrorist financing.

Disclosure of cases related to tax evasion is insufficient

2.64 The legislation requires FINTRAC to disclose designated information to the Canada Revenue Agency if it determines that, in addition to money laundering or terrorist financing, the information suggests possible tax evasion.

2.65 Of 301 disclosures FINTRAC made to the end of March 2004, it made only three to the Canada Revenue Agency, two of which related to the same target. This disclosure rate appears to be unusually low.

2.66 It is important that FINTRAC provide information to the Canada Revenue Agency because often where cases do not meet the threshold for criminal prosecution, civil liability for unpaid taxes may be possible. At any rate, FINTRAC must ensure that it makes such disclosures when information merits it, because it is required by law to do so.

2.67 **Recommendation.** In consultation with the Canada Revenue Agency (CRA), FINTRAC should establish criteria for disclosure to CRA of cases involving possible tax evasion and should refer cases to the CRA that meet the criteria.

FINTRAC's response. The Canada Revenue Agency and FINTRAC are working together to define and establish indicators that would enable FINTRAC, once it has reasonable grounds to suspect that its information would be relevant to a money-laundering or terrorist-activity financing offence, to more readily determine whether the information would also meet the separate statutory test of being relevant to an offence of evading or attempting to evade taxes. FINTRAC and the CRA have been working together to design and deliver a workshop on indicators and typologies for staff from both agencies at the earliest opportunity.

Canada Revenue Agency's response. The Canada Revenue Agency fully agrees with this recommendation. The development of the criteria for disclosure of possible tax offences is a priority for the CRA and we are prepared to proceed expeditiously.

Compliance

2.68 FINTRAC is responsible for ensuring that all entities subject to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* comply with their obligation under the Act to report certain transactions, keep records, identify clients, and implement an effective system of compliance.

2.69 FINTRAC's compliance function comprises three types of activity:

- outreach, to encourage reporting entities to comply;
- monitoring, to verify compliance; and
- referrals to law enforcement, to deal with willful non-compliance.

Outreach to reporting entities is extensive but provides little strategic intelligence

2.70 FINTRAC's approach to compliance is built on partnership and the assumption that reporting entities are willing to comply. It therefore concentrates heavily on education and outreach efforts to make sure that reporting entities are aware of the requirements of the legislation and comply with them.

2.71 Measures FINTRAC uses to promote awareness and compliance include

- guidelines, advisories, pamphlets, press releases, and an annual report, all of which are available on its Web site;
- presentations to individual reporting entities and at industry conferences across the country; and
- consultations with reporting entities and their associations.

2.72 FINTRAC has established a working group for each reporting sector and a framework to formalize consultations with each sector. Its ongoing consultations with the Canadian Bankers Association have significantly improved its relationship with this key business sector. Outreach efforts have been less effective with insurers, securities dealers, and real estate agents, in part because they do not see that money laundering is relevant to them, despite evidence to the contrary.

2.73 This misconception reflects the need for more concrete, specifically targeted information on money laundering and terrorist financing. Up-to-date reports on techniques and trends in specific sectors can help reporting entities understand their own risks and where they might be vulnerable. Publishing cases of money laundering and terrorist financing, in a sanitized form if necessary to safeguard personal privacy, would also help increase awareness and improve compliance and reporting.

2.74 As FINTRAC points out in its latest Report on Plans and Priorities, it is "uniquely positioned to provide strategic intelligence on broad trends and emerging developments in money laundering and terrorist activity financing to partners and stakeholders engaged in anti-money laundering and anti-terrorism efforts." To date, however, it has taken little advantage of this position to develop and disseminate strategic intelligence. Representatives of reporting entities and law enforcement agencies told us they would welcome such "big picture" information and were disappointed that FINTRAC was not providing it. FINTRAC says the reporting regime is still young and it is too soon to draw conclusions.

Unregulated reporting entities pose significant compliance challenges

2.75 Compliance with anti-money-laundering requirements by federally regulated life insurance companies and deposit-taking institutions is assessed by the Office of the Superintendent of Financial Institutions (OSFI). OSFI has been issuing guidance since 1990 on sound practices for deterring and detecting money laundering. As part of supervising regulated financial institutions, OSFI reviews the adequacy of their anti-money-laundering practices and procedures and their compliance with the legislation. Provincial regulatory agencies perform similar supervision of provincially regulated institutions.

2.76 To make the best use of its own resources and minimize duplication of effort, FINTRAC intends to rely on federal and provincial regulators for the primary monitoring of regulated institutions. Legislative amendments that allow FINTRAC to share compliance information with regulators came into effect on 1 June 2004, and FINTRAC has already signed a memorandum of understanding with OSFI that provides for such information sharing. FINTRAC is negotiating similar arrangements with provincial regulators, and moving forward on this is critical—the more closely the opportunities for money laundering are monitored at the federal level, the more incentive there is to move money-laundering activities to the provincial level.

2.77 The unregulated sector poses significantly bigger compliance challenges. It includes accountants and real estate agents, who at least are licensed and subject to some monitoring by their professional associations. But it also includes money service businesses, which—apart from their obligations under the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act*—are neither licensed nor regulated. Indeed, there are no reliable figures on how many such firms exist. FINTRAC has attempted to build an inventory from telephone directories and newspaper ads, but the task is next to impossible: many money services are a part of other businesses such as travel agencies, small grocery stores, and gas stations; and they might not advertise. Complicating the task further, these services go in and out of business at a high turnover rate.

2.78 The Financial Action Task Force on Money Laundering recommends that money service businesses be registered as a means of keeping track of them. Several countries, among them the U.S. and the UK, require these businesses to register. But the need for federal/provincial co-operation to implement an effective registration system complicates this option for Canada more than for most other countries.

2.79 There is a concern that requiring them to register may drive some of these businesses underground, although legitimate businesses would likely welcome the requirement. At present, a money service business may find that banks are reluctant to deal with it because they cannot be sure that it is complying with requirements related to money laundering and terrorist financing.

2.80 Registration would make it easier to monitor compliance by generating a list of licensed money service businesses; communication would also be easier. Finance Canada, with its Initiative partners, is considering options for licensing or registering money service businesses.

Enforcement mechanisms are incomplete

2.81 Along with outreach and monitoring, an effective compliance system also needs the capacity to impose appropriate penalties when reporting entities demonstrate willful non-compliance. The *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* provides for penalties of up to five years in prison and up to $2 million in fines for non-compliance.

2.82 With many more reporting entities than resources available to monitor their compliance, enforcement action is critical to deterring non-compliance. People we interviewed in this audit pointed out that penalties in Canada are already more lenient than in the U.S. If a perception develops that enforcement is also lax, compliance will suffer.

2.83 This is not news to FINTRAC. An internal report in May 2003 argued that the lack of enforcement was creating a competitive inequity that had to be addressed "to ensure that those who invest in compliance are not disadvantaged in the marketplace by having implemented compliance programs compared to non-compliers who have not invested."

2.84 Part of FINTRAC's compliance program calls for the development of policies and procedures for referring cases of non-compliance to law enforcement. At the time of our audit, these policies and procedures were still being developed and no referrals had been made. Outreach and education promote compliance by entities that are willing to comply; but when education fails, FINTRAC must be prepared to take the next step.

Performance measurement and reporting

Information on the Initiative's effectiveness is limited

2.85 Soon after the National Initiative to Combat Money Laundering received legislative approval in June 2000, Finance Canada in collaboration with the other Initiative partners prepared a comprehensive evaluation framework to assess the appropriateness of the funding levels. The framework had two stages: a limited assessment in the third year of the Initiative would focus on program design and implementation, and a more extensive evaluation in the fifth year would assess the impacts of the Initiative compared with the anticipated outcomes. In addition, section 72 of the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* provides that the administration and operation of the Act be reviewed by a parliamentary committee within five years of that section's coming into force, that is, by 5 July 2005.

2.86 However, timely information on the ongoing performance of the Initiative is also needed to manage it and meet accountability objectives. The Treasury Board requires that departments and agencies measure program performance, relate it to program objectives, and report on results achieved. Indicators by which to measure performance are to go beyond activities and outputs to outcomes. Weighed against these requirements, the information on the Initiative that has been collected and reported to date is limited.

2.87 The Initiative's basic purpose is to detect and deter money laundering and terrorist financing. That is how FINTRAC, as a central player in the Initiative, defines its own strategic outcome. Yet the performance indicators it has set out in its Strategic Plan and Departmental Performance Report are mostly measures of operations—for example, numbers of reports received, disclosures made, compliance initiatives introduced, contacts made with stakeholders, and memoranda of understanding signed. Even for these, FINTRAC has set no targets or expectations that could be used by management to know whether it achieved what it set out to achieve, and by Parliament to assess the agency's performance.

2.88 FINTRAC attributes this focus on the operational level partly to its status as a young agency, still developing. It says it will be shifting its emphasis to the impact of its products and activities. In January 2004, its Executive approved an Integrated Performance Management Framework designed to identify key measures of performance and develop appropriate systems to collect the necessary data. Based on a "scorecard" model, the framework is expected to provide benchmarks and indicators that will inform management each quarter of results achieved relative to established targets. Development of the framework was under way at the time of our audit, with completion targeted for the end of September 2004.

2.89 Much of the information that FINTRAC needs to assess its performance comes from outside the agency. Financial intelligence that it provides to law enforcement and security agencies through case disclosures is FINTRAC's main product. It needs feedback on these disclosures in order to know how they are being used and what difference they make. In 2003, FINTRAC set up a working group to develop options for collecting feedback on disclosures, but feedback remains largely anecdotal and episodic.

2.90 Early in 2004, the RCMP's Financial Crimes Branch agreed to put arrangements in place to track the status of cases disclosed by FINTRAC and report to it regularly. FINTRAC does not yet have any similar arrangements with other law enforcement and security agencies.

2.91 Information on actions taken in response to FINTRAC disclosures is necessary not only so that FINTRAC can assess its own performance but also so the performance of the Initiative overall can be evaluated, since those disclosures are the Initiative's main product. It is not possible to assess the Initiative's effectiveness without information on the impact that FINTRAC disclosures have had on the investigation and prosecution of money-laundering and terrorist-financing offences. All partners in the Initiative thus have a shared interest in co-operating to establish mechanisms for tracking the use of FINTRAC disclosures and measuring their effects, to the extent that is possible. For accountability purposes, summary information on these results needs to be reported to Parliament regularly.

2.92 **Recommendation.** The government should establish effective mechanisms for monitoring the results of disclosures, including the extent to which disclosures are used and the impact they have on the investigation and prosecution of money-laundering and terrorist-financing offences. It should report summary information on these results to Parliament regularly.

Finance Canada's response. Many of the initiative partners have already begun to put in place various tracking systems that will provide greater feedback on the use and impact of FINTRAC disclosures. As well, FINTRAC is currently discussing methods to track disclosures with provincial and municipal police forces.

The Department of Finance will consider the value of how often to report to Parliament. Additional reporting would have to complement the existing reporting requirements of Initiative partners, the upcoming agenda of parliamentary reviews, and the requirements for periodic evaluations of the Canadian anti-money-laundering and anti-terrorist financing regime by the Financial Action Task Force.

Conclusion

2.93 The National Initiative to Combat Money Laundering is relatively new, and the elements required for its effective implementation and accountability to Parliament are not yet fully in place. Certain design features also constrain the capacity of the Initiative to deliver on its main objective of detecting and deterring money laundering and terrorist financing.

2.94 **Disclosure of financial intelligence.** Legislative restrictions limit FINTRAC's ability to provide good-quality financial intelligence on money laundering and terrorist financing. Information that FINTRAC is permitted to disclose can be useful when it relates to a current investigation, by corroborating findings or providing new leads. Otherwise, law enforcement and security agencies normally find that the information FINTRAC discloses is too limited to warrant action. In short, as the system now works, FINTRAC disclosures can contribute to existing investigations but rarely generate new ones.

2.95 **Compliance.** FINTRAC has an extensive outreach program to help reporting entities understand their obligations. However, it provides limited feedback on the reports it receives from them, and little information on trends in money laundering and terrorist financing to help them identify suspect transactions and produce better reports. Moreover, FINTRAC has not fully implemented policies and procedures to monitor and ensure these entities' compliance with legislative requirements. The exemption of legal service providers from reporting requirements also undermines the system's effectiveness.

2.96 **Accountability mechanisms.** Appropriate mechanisms to track the use of FINTRAC disclosures have not been implemented by all recipients of disclosures. In the absence of a comprehensive system of monitoring the use of disclosures, FINTRAC cannot assess the value of the intelligence it provides and how it can be improved. And it is equally impossible to assess the overall performance of the Initiative and its impact on money laundering and terrorist activities in Canada.

2.97 Our audit identified a number of government actions needed to make the Initiative more effective:

- Broaden the kinds of information that FINTRAC may disclose, within limits that respect the privacy rights of Canadians.

- Implement a management framework to provide direction and strengthen the co-ordination of efforts within the federal government and with stakeholders at other levels of government and in the private sector.
- Establish accountability structures to ensure that the information needed for measuring the Initiative's performance is collected and that results are reported to Parliament regularly.

2.98 Legislation calls for parliamentary review of the Initiative by 5 July 2005. The parliamentary committee conducting that review may wish to look at these issues and at whether lawyers are still exempt from the anti-money-laundering legislation, as they have been since March 2003 following successful legal challenges.

About the Audit

Objectives

The objectives of the audit were to determine whether the management framework for implementing the National Initiative to Combat Money Laundering

- is appropriately designed to promote detection and deterrence of money-laundering and terrorist financing, and
- provides accountability to Parliament for results achieved.

Scope and approach

FINTRAC and its operations were the focus of the audit, although we also examined the anti-money laundering activities of other partners in the Initiative and in particular their relationship to FINTRAC.

The audit assessed whether the government has developed and put in place mechanisms, systems, and procedures to

- produce and disseminate good-quality financial intelligence on money laundering and terrorist financing,
- ensure compliance with anti-money-laundering and terrorist-financing requirements,
- collect data on results achieved, and
- measure and report on performance.

We built on the knowledge base established during our April 2003 study of the government's strategy to combat money laundering. We also reviewed relevant literature, laws and regulations, and international standards on measures against money laundering and terrorist financing. We examined disclosures made to law enforcement and security agencies and foreign financial intelligence units (including the analytical reports supporting these disclosures). We analyzed data and reviewed departmental documents, surveys and evaluations, management files, and reports. We also interviewed departmental and agency officials and representatives of law enforcement agencies (federal, provincial, and municipal police forces), as well as officials of federal and provincial regulatory agencies and representatives of reporting entities.

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Report of the Auditor General of Canada to the House of Commons—November 2004

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to the House of Commons

NOVEMBER

Chapter 3
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Upgrading the CF-18 Fighter Aircraft

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

3

National Defence

Upgrading the CF-18 Fighter Aircraft

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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National Defence
Upgrading the CF-18 Fighter Aircraft

Main Points

3.1 Fourteen years will have elapsed from the time National Defence identified the need to modernize the CF-18 until Phase 1 upgrades are completed on 80 of 119 fighter aircraft in 2006. Phase 2 concludes the modernization and is scheduled for completion in 2009, after which National Defence expects to fly the CF-18 until 2017 or longer. Delays in the approval processes, the budget cutbacks of the late 1990s, and the increasing cost of maintaining existing equipment have contributed to the length of time taken before the aircraft's deficiencies could be fixed.

3.2 In Phase 1, we found some problems with project and risk management, staff shortages, and approval delays. These concerns need to be addressed so that they do not become impediments to the successful completion of Phase 2. If they aren't addressed, the final delivery of fully upgraded CF-18s could be delayed beyond 2009. The current CF-18 airframe has a limited amount of flying hours left, so the Department needs to take full advantage of its investment in the modernization by ensuring upgrades are installed and available to pilots as soon as possible.

3.3 We looked at the largest-dollar contract for each of the five upgrades and found them to be within cost. We found that the work being done on the aircraft was addressing critical deficiencies and National Defence officials were satisfied that the aircraft being delivered at the time of our audit were meeting the Department's performance expectations.

3.4 When delays and staff shortages threatened certain testing milestones, operational and technical test staff at the Department worked together to overcome those problems and meet their deadlines.

3.5 Three of the five Phase 1 upgrades are proceeding on time; two are behind schedule. One, a flight simulator training system, was to be ready for pilot training by the time Phase 1 upgraded aircraft were delivered; instead, the system is delayed by up to two years. As a result, the Department will forgo savings expected by using the old training system until the new one arrives and may see increased fatigue on the aircraft due to added flying training hours.

3.6 In order for National Defence to get full advantage of the improved operational capabilities until 2017 or longer, it must ensure that it can address existing pilot shortages, shortages of air technicians who maintain the aircraft, shortages of spare parts to keep the aircraft flying, and budgetary pressures on operational funding. Until these concerns are resolved, National Defence cannot get assurance that the $2.6 billion investment in the CF-18 will enable it to meet operational demands until 2017 or longer.

Background and other observations

3.7 National Defence is modernizing 80 of its CF-18s to fix capability deficiencies that have existed since the early 1990s. The $2.6 billion multi-year, multi-project upgrade will enable the Air Force to fly these aircraft until 2017, or longer, with improved avionics, weapons, and communications systems.

3.8 When purchased in 1980, the CF-18 life expectancy was up to 2003. However, by 1992, after deploying the aircraft to the Gulf War in 1991, the Department had concerns about several deficiencies.

3.9 With ongoing maintenance, some upgrade work, and structural fatigue life management, the Department planned to prolong the life of the pre-modernized fleet to 2010, recognizing it could continue to fly, but its capabilities would be limited. In 1998, National Defence granted internal approval to begin modernizing the CF-18 aircraft fleet through a series of incremental upgrades and modifications. These would occur between 2001 and 2009 and address critical deficiencies such as identifying friend or foe aircraft, effectively interoperating with other aircraft in joint operations, communicating on continually secure channels, and defending against jamming of its radio and radar. The number of aircraft to be modernized was based primarily on affordability. Plans for the 39 remaining aircraft were not finalized at the time of our audit. Some of these aircraft have been used as a source of spare parts.

3.10 In our 2001 Report, Chapter 10, National Defence In-Service Equipment, we reported on the availability of military equipment and looked at the performance of the CF-18. We examined abort rates, which are the number of failures per 1,000 flying hours that result in cancelled missions, and found that the CF-18 was experiencing a growing number of aborts. Aging and reduced funding combined to restrict the performance and availability of these aircraft.

The Department has responded: National Defence agrees with all the recommendations and has committed to taking action to address concerns we raise in this chapter.

Introduction

3.11 The primary roles of the CF-18 aircraft are to maintain air sovereignty over Canada, help defend North America, provide tactical support for joint operations, and contribute to North Atlantic Treaty Organization (NATO) missions. Because of these roles, the aircraft needs equipment to communicate and work with allied aircraft and ground forces, defend against attacks, and provide surveillance.

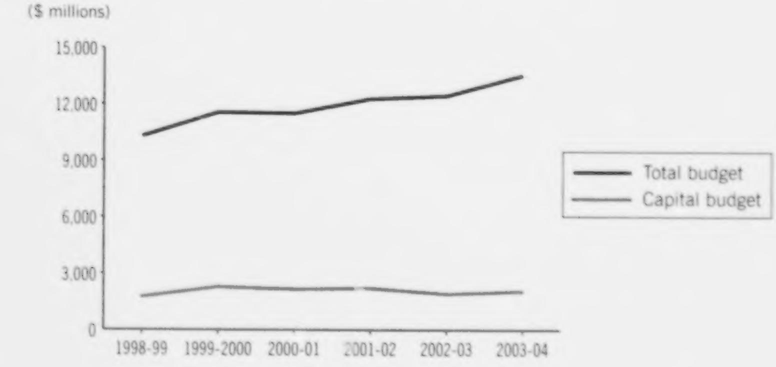
3.12 The CF-18 is an aging aircraft but, according to National Defence, it can operate until 2017 or longer if upgraded and maintained. However, it must compete for funding with other equally aging military platforms. National Defence has had to balance its demands for spending with available funding.

Capital spending has continued to decline

3.13 We last reported on the need for National Defence to increase the capital portion of the defence budget in our April 1998 Report, Chapter 3, National Defence—Equipping and Modernizing the Canadian Forces. Since then, spending on capital equipment has decreased both as a percentage of overall funding and in real terms. Funds for updating or buying new equipment continue to be pressured by increasing operational costs. The Department pointed out in an internal analysis of capital spending that "the lack of stable capital funding can lead to the costly and inefficient cancellation, deferral, or smoothing of cash flows of capital equipment acquisitions."

3.14 The budget for National Defence has grown in the last few years, mainly to cover the increasing costs of operations and personnel (Exhibit 3.1). During this time, capital spending remained relatively stable at $2 billion annually but decreased from around 19 percent of the overall defence budget to 15 percent.

Exhibit 3.1 National Defence total and capital budgets



Source: National Defence

3.15 **Addressing equipment needs.** As more and more equipment ages and becomes operationally obsolete, the demand for upgrades or replacements increases. Projects are deferred when funds are not available. We reported in 1998 that the number of deferred projects was growing and outpacing the ability of National Defence to address its equipment deficiencies or modernize its capabilities. This problem is not unique to Canada. Equipment rust-out is a challenge faced by many allies.

The CF-18 Incremental Modernization Project

3.16 National Defence is upgrading 80 of its fleet of 119 CF-18s in two phases over nine years from 2001 until the planned completion date in 2009. The CF-18 Incremental Modernization Project consists of 15 projects. We examined five of the projects, which were scheduled for completion between 2001 and 2006. Of the five projects, three involve modifications to the aircraft, the fourth involves the acquisition of a network of training simulators for a fully modernized CF-18, and the fifth is a developmental project for multi-purpose colour displays in the cockpit.

3.17 Phase 1 is planned for completion in 2006 and will cost approximately $1.5 billion. We found that three of the five projects were on track. The simulator project experienced significant delays but is now underway, and the Department moved the installation phase of the multi-purpose colour displays to Phase 2 after it fell behind schedule. Without the Phase 1 projects that modernize the aircraft systems and software, Phase 2 upgrades cannot be completed. In order for Phase 2 to start on time, Phase 1 must be completed on time.

3.18 Given the number of projects, their individual complexity, and their degree of integration, both phases present difficult challenges (exhibits 3.2 and 3.3). Some Phase 1 upgrades provide the foundation for Phase 2 projects.

Focus of the audit

3.19 We focussed on the projects included in Phase 1 (2001-2006) of the CF-18 upgrade. We examined the acquisition process for three on-aircraft projects, the Advanced Distributed Combat Training System (ADCTS) project for flight simulation training, and the development of the new colour displays. The development work for a sixth project, Data Link, was added after we started the audit, so we did not examine it. We did not assess the military decision to modernize the CF-18 aircraft but rather focussed on whether the upgrades will address identified deficiencies.

3.20 We examined the work by National Defence, Public Works and Government Services Canada, and the Treasury Board of Canada Secretariat to identify needs, examine options, approve expenditures, award contracts, manage contracts, manage project risk, and oversee programs. Further information about the audit objectives, scope, approach, and criteria can be found at the end of the chapter in **About the Audit**.

Exhibit 3.2 Estimated cost of CF-18 modernization

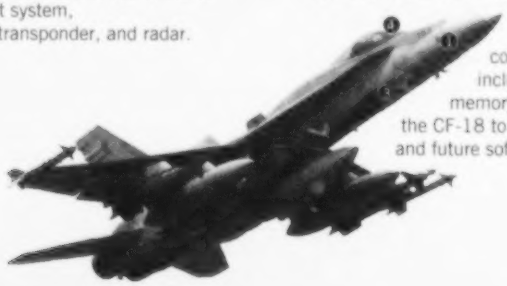
Project description	Estimated total cost ($ millions)
Phase 1 (2001-2006)	
On-aircraft modifications	
Mission computers	$31.00
Software	151.41
ECP-583 • Radio • Interrogator/transponder • Radar • Stores Management System	1,009.00
Off-aircraft activities	
ADCTS simulators	200.70
Multi-purpose colour displays (integration)	62.00
Total audit scope	**1,454.11**
Data Link (integration)	23.00
Phase 2 (2004-2009)	
ECP-583R2 • Counter Measures Dispensing System • Helmet Mounted Display • Data Link (installation) • Multi-purpose colour displays (installation)	$444.44
Defensive Electronic Warfare Suite • Radar warning receiver • Electronic pulse jammer	Yet to be funded
Associated projects	
Global Positioning System	27.00
Night vision	24.00
Air combat manoeuvring instrumentation	34.00
Weapons projects	
Advanced Multi-role Infra-red Sensor	199.10
Medium Range Advanced Air-Air Missile	145.70
Advanced Precision Guided Munitions	36.00
Short Range Advanced Air-Air Missiles	177.00
Total CF-18 Incremental Modernization Project	**$2,564.35**

Exhibit 3.3 Overview of CF-18 Phase 1 upgrades

On-aircraft projects

ECP-583 ① integrates the major and most complex systems into the aircraft and is the foundation for other major components. New components include radio, stores management system, interrogator/transponder, and radar.

The **mission computer** ② and **software** ③ function as the heart of the CF-18's avionic systems. This upgrade is the foundation for other major components. The mission computers upgrade includes increased memory and will allow the CF-18 to utilize current and future software upgrades.



Off-aircraft projects

Multi-purpose display group (MDG) ④ consists of the design of state-of-the-art colour displays that will provide better imaging, enhanced colour capability, and cost-effective maintainability. They will be installed during Phase 2.

The **Advanced Distributed Combat Training System** simulators will provide a cost-effective, yet realistic, means of training. The simulators will be delivered to 4 Wing at Cold Lake, Alberta and 3 Wing at Bagotville, Quebec.

Observations and Recommendations

Upgrading aircraft capability

Dealing with CF-18 deficiencies

3.21 National Defence identified the CF-18 deficiencies that, in its view, needed to be addressed. In our audit, we looked at whether the contracts for the CF-18 Incremental Modernization Project for Phase 1 addressed those deficiencies, which consisted of the following:

Avionics—The onboard electronics used for piloting aircraft.

- **Supportability.** The aircraft industry no longer produces most of the original CF-18 avionics components. Equipping the CF-18 with modern avionics will allow the Department to maintain the aircraft into the future.
- **Interoperability.** Many of Canada's allies are updating their aircraft. To continue to communicate and operate effectively with allies, the CF-18 requires similar updates.
- **Operational capability.** The CF-18 needs upgrading to continue to perform as an effective fighter aircraft. Some of the potential threats to Canadian security are new since the CF-18 was first built.

- **Survivability.** Certain components that increase the survivability rate of the aircraft and its pilots are now obsolete. The Phase 1 upgrades will contribute to improved survivability.

3.22 We noted that other defence projects address some deficiencies; for example, the CF-18 Crash Survivable Flight Data Recorder is included as part of a separate Air Force-wide project.

Need to modernize first recognized in 1990–91

3.23 National Defence first recognized the need to modernize its CF-18s during the 1990-1991 Gulf War but could not get an upgrade program started until 1998 (Exhibit 3.4). In 1992, it proposed the CF-18 Mid-Life Update project to replace the following components: new mission computers, a new operational flight program, a new stores management system that enables the aircraft to use newer weapons, new communication systems, and new radar. The Department brought forward these equipment requirements again in 1994 under the new name Systems Life Extension Project to emphasize the focus on mission systems. Finally, in 1998, the Department received approval for its new strategic approach of a series of incremental projects, namely, the CF-18 Incremental Modernization Project. Although they were part of that project, the new mission computers and operational flight program projects were approved separately that year. The stores management system, communication systems, and radar were all approved as parts of the ECP-583 project in 1999.

3.24 **Decision to upgrade 80 aircraft.** We expected to find an analysis to support why the Department chose 80 aircraft as the number to modify. We expected that this analysis would take into account the many variables affecting the estimated useful life of the aircraft, including its expected attrition rate, age, and roles as defined in National Defence policy. We were unable to find such an analysis. However, Department officials told us that upgrading 80 CF-18s was reasonable, financially. Yet, new threats to North America in light of global events over the past two years may increase the demands on the upgraded 80-aircraft fleet and may put even greater pressure on the Air Force to manage its fatigue life, maintenance, and flying hours.

3.25 Air Force analysis indicates that modernizing 80 aircraft does not mean that 80 aircraft would be available on a daily basis. The planned allocation of the 80 CF-18s is four operational squadrons of 12 aircraft each, with the remaining 32 available for training, testing and evaluation, and depot level maintenance. Of the 48 aircraft in operational squadrons, only 70 percent, or 34, are normally mission-ready on a daily basis. With an expected attrition rate of one aircraft every two years, National Defence has recommended a review of how well the modernized 80-aircraft fleet will meet Canada's ongoing commitments, particularly in a post-September 11, 2001 environment.

Exhibit 3.4 **A brief history of CF-18 modernization**

	1980	National Defence buys 138 CF-18s from contractor.
First CF-18s delivered to National Defence.	1982	
	1991	24 CF-18s participate in Gulf War.
CF-18 Mid Life Update project proposes to address avionics system deficiencies.	1992	
	1994	Update project replaced by the CF-18 System Life Extension. Defence White Paper issued, affirms the need to maintain a modern, multi-purpose, interoperable armed forces.
Statement of Requirements approved, defining minimum operational requirements to be addressed.	1995	
	1998	CF-18s participate in the former Yugoslavia with NATO allies. The project is revised and approved as the Omnibus CF-18 Incremental Modernization Project (CF-18 IMP). The project becomes a series of incremental projects rather than a single large major capital project. Mission computer and software upgrade projects approved.
Contractor proposes ECP-583 for the CF-18, an integration package for the CF-18 modernization that amalgamates four projects, thereby mitigating risk.	1999	The CF-18 Modernization plan is now divided into two phases. Phase 1 integrates the core avionics that form the foundation for other projects in Phase 2. ECP 583 is the cornerstone project of CF-18 IMP and Phase 1. Simulators will be procured in parallel with Phase 1.
ECP-583 receives Treasury Board approval; contract for ECP-583 awarded to the contractor.	2001	
	2002	The Advanced Distributed Combat Training System (ADCTS) simulators obtain Treasury Board approval.
Phase 1 installed and tested on 2 prototype CF-18s at China Lake, California.	2003	Steady production of modernized CF-18s begins. Pilots begin flying modernized CF-18s during training operations.
Contract for the ADCTS simulators awarded.	2004	
	2006	Phase 1 upgrades scheduled for completion and work on the Phase 2 upgrades is scheduled to begin.
Phase 2 scheduled for completion.	2009	
	2017+	Estimated lifespan of fully upgraded and properly maintained CF-18s.

3.26 **Recommendation**. We recommend that the Department of National Defence review the modernized fleet's ability to meet Canada's commitments, particularly subsequent to September 11, 2001.

National Defence's response. National Defence appreciates the importance of ensuring that the modernized fleet will have the capacity to meet Canada's existing commitments. The Canadian Forces and National Defence have

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National Defence's response. National Defence appreciates the importance of ensuring that the modernized fleet will have the capacity to meet Canada's existing commitments. The Canadian Forces and National Defence have processes and analysis tools to monitor and match resources with commitments. One tool, developed by the Department's Operational Research division, is the Air Force Structural Analysis (ASTRA) model. ASTRA is an analytical model that calculates the resources required to meet specified commitments. Employing these processes and analysis tools, and taking into account September 11, 2001 and other relevant influences, National Defence will review the capacity of the modernized fleet to meet Canada's existing commitments.

Management of individual projects

Three of five projects on schedule

3.27 **Projects on time.** We found that the mission computers, operational flight program, and Engineering Change Proposal 583 (ECP-583) projects were on schedule. Equipment for these projects is being installed simultaneously.

3.28 The ECP-583 is the main upgrade that replaces obsolete systems and installs better radios, radar, a better weapons management system, and a friend-or-foe identifier. It will cost about $1 billion to complete. National Defence was able to take advantage of work already done by the contractor to develop and install an ECP-583 for the United States Navy and the Royal Australian Air Force. Thus, this was mainly an off-the-shelf purchase of a known product by an experienced contractor.

3.29 The new operational flight program software runs the upgraded mission computer, which consists of the navigation computer and weapons delivery computers. Both projects are on track and on time.

3.30 National Defence is receiving CF-18s with the ECP-583, the operational flight program, and the mission computer work completed according to schedule from the contractor. As a result, the Department has been able to meet its own target to deliver two squadrons of Phase 1 upgraded aircraft that are capable of performing North American Aerospace Defense Command (NORAD) roles. At the time of our audit, the contractor had delivered 33 aircraft, upgraded to the Department's satisfaction and on time.

3.31 **Projects behind schedule.** However, the remaining two Phase 1 projects are behind schedule. The Department has pushed back the multi-purpose display group project to Phase 2. The project involves installing state-of-the-art colour displays to provide more and faster operational information to pilots in an easy-to-understand format. The Department is developing the project in collaboration with the Royal Australian Air Force (RAAF), which is also upgrading its F/A-18s. Under the terms of a memorandum of understanding, Canada is responsible for the development of pre-production displays. Responsibility will then transfer to the RAAF, which will lead the development and testing phases. The Department chose collaboration so that it could share costs with a partner. Department officials report that the delay will have no operational impact, and they remain confident that this joint project will fit in the Phase 2 time frame.

3.32 The Advanced Distributed Combat Training System (ADCTS) will provide simulators for pilot training. However, it is two years behind schedule and the Department now plans delivery for 2005 (see Costly delays: The Advanced Distributed Combat Training System project).

Delays pose problems

3.33 **Overcoming testing delays.** National Defence worked with the United States Navy and the contractor to test its ECP-583 upgraded aircraft. During late 2002, the Department faced delays getting a prototype aircraft ready for testing. A Combined Test Force, composed of operational and technical test staff, worked around staff shortages and an absence of baseline data with which to compare results. It kept expertise together and enabled test personnel to share resources to ensure that the work could get done. It allowed test personnel to complete all necessary test steps and evaluate the results. Because of this group, the impact of the delay in receiving the prototype aircraft was minimized.

Costly delays: The Advanced Distributed Combat Training System project

The CF-18 Advanced Distributed Combat Training System (ADCTS) project will replace the existing 20-year-old CF-18 flight simulators with a state-of-the-art, high-fidelity networked system that emulates air combat. The system will improve pilot training far beyond that provided by existing simulators. ADCTS will provide CF-18 pilots with a virtual battle space, complete with appropriate visual terrain, threats, and targets. In addition to regular fighter pilot training, ADCTS will allow CF-18 fighter pilots to link with other simulators, including those within the Canadian Forces and of our NATO allies. Many of those allies, including the U.S. and the UK, use similar systems for their pilots.

Yet, despite very strong support by all levels of senior management at National Defence, the ADCTS project met a series of approval delays and fell far behind schedule. The original project plan called for the first of the "part-task" simulators to be ready by April 2003 for CF-18 pilots' transition to the modernized aircraft. Because of delays, the Air Force was not expecting the part-task simulators until September 2004 at the earliest and the first of the full simulators by 2005. The upgraded aircraft began arriving in August 2003.

A former chief of the air staff called these delays unacceptable. They will have important impacts on the Department and on the pilots who fly the aircraft. Since November 2003, one squadron of CF-18 pilots has been using the aircrafts' new and complex avionics systems during live flight training operations without simulation training. This could affect pilot combat abilities and flight safety.

Project staff determined that ADCTS could meet 40 percent of the current flying training requirement to keep up to the demands on the upgraded CF-18 fleet. In addition, Department staff estimate that in 2006, once the simulators are fully integrated within the training system, they will save $12 million annually. Because of the delays, however, the Department will be forgoing some portion of these annual savings. The Department could not provide an estimated amount of the forgone savings.

Pilots will need more flight hours in the aircraft to bring them to the required level of readiness. As a result, the planned reduction in flying hours will not be achieved. The flying hours associated with training flights can be tough on aircraft and may decrease their life expectancy. As well, aircraft tied up in training roles are not available for operational roles. The delay in ADCTS may reduce the estimated life expectancy of the CF-18 by as much as two to three years.

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3.34 **Simulator delays.** National Defence began working on the Advanced Distributed Combat Training System project in late 1999 and planned to begin using the simulators in April 2003 to assist with pilot training for upgraded CF-18s as the aircraft came into service. However, the project fell behind schedule when it went before a series of departmental project committees, each with its own mandate and review processes, for approvals. The project received final departmental approval in November 2001.

3.35 In May 2002, the government approved the $200 million purchase of ADCTS. The purchase included ten portable "part-task" simulators and six full simulators for pilot training on the upgraded CF-18s. The Request for Proposal process began in September 2002. Despite the need for the simulators, the contracting process took longer than expected, and it was not until March 2004—almost two years after project approval—that the contract was awarded.

3.36 Because of these delays, National Defence was expecting to receive the first of the part-task simulators in September 2004 and the full simulators in September 2005—more than two years after pilots began flying modernized CF-18s.

3.37 **Plans to improve the acquisition process.** The project approval process is one of many components of the acquisition process. CF-18 project staff indicated that the main challenge to staying on schedule was that process, over which they have no control.

3.38 National Defence has targeted the lengthy acquisition process for reform. One of the Department's main plans to shorten the acquisition process is to streamline the approval process and make it more responsive and effective.

3.39 A 1998 department study revealed that most capital equipment projects took, on average, 16 years from concept to project completion. The Department acknowledged that this is an unacceptable length of time and committed to shortening the process by at least 30 percent—to 11 years. In December 2003, the Department developed a new project approval process to reduce internal approval times and in 2004 was working on an implementation plan.

Managing the acquisition process

Testing and evaluating results are acceptable

3.40 According to National Defence, the primary purpose of testing and evaluation is to identify, understand, and manage the technical and performance risks associated with equipment design, manufacture, and in-service support. The director of technical airworthiness is the delegated technical airworthiness authority under the *Aeronautics Act* and ensures that the airworthiness program achieves an acceptable level of aviation safety from a technical perspective. We reviewed the Department's testing and evaluation processes to identify whether it carried them out according to its policies. We did not audit whether the testing and evaluation processes were comprehensive and accurate; rather, we reviewed the test plans and results with the appropriate officials and found that the Department was satisfied that the aircraft was operationally acceptable.

3.41 National Defence conducted two types of testing and evaluation: engineering and operational. Engineering verified the technical airworthiness of the new design and that the modified aircraft met performance expectations. Operational verified the operational effectiveness and suitability of the changes made to the test aircraft. Although the start of testing and evaluation was delayed by three months due to the late completion of the test aircraft, the testing and evaluation team met their milestones, as described earlier.

3.42 Test engineers found some problems with the new software and the radios. The Department was investigating these problems at the time of our audit. National Defence officials told us the Director of Technical Airworthiness was examining the engineering test and evaluation trouble reports and had provided a provisional technical airworthiness clearance. This clearance signifies that there are no significant airworthiness issues and is provided pending resolution of the remaining issues. The project staff and technical airworthiness staff were working toward full technical airworthiness clearance in the fall of 2004.

3.43 National Defence told us that it is satisfied with the performance of the modernized aircraft now in service.

Department followed contracting policy and procedures

3.44 **Contracts.** We examined the largest-dollar contract in each of the five projects. All are within costs and the payments are on schedule. Contract payments are based on the delivery of aircraft, spare parts, documentation, hardware, and training that have been delivered by the contractor according to either milestones or on a time-and-material basis, as required by the contract.

3.45 For the ECP-583, the government authorized $152 million for training, spare parts, contract amendments, and other costs. Approximately $51 million in contract amendments had been approved at the time of the audit, mainly for maintenance training. Expenditures are well within the $152 million.

3.46 We reviewed whether the five contracts complied with trade agreements by examining whether the sole-sourced procurements in four of the five contracts were exempt from the North American Free Trade Agreement and the World Trade Organization rules. We did this by comparing the contract requirements against the lists of goods from the trade agreements that may not be sole sourced. In all four contracts, the decision to sole source was based on the ownership of the technical rights associated with the procured goods. Finally, for the lone competitive contract we ensured that the steps taken in the contracting process met those established in the Public Works and Government Services Canada (PWGSC) Supply Manual.

Sole source contracts—There are four instances when a government department may sole source a contract instead of asking for bids from more than one supplier. The Treasury Board allows for sole sourcing in an emergency situation, when the estimated cost is below a certain amount, when soliciting bids would not be in the public interest (for example, for security reasons), and when only one company or person is capable of performing what is required by the contract. The Treasury Board's Contracting Policy states, "This last exception . . . should be invoked only where patent or copyright requirements, or technical compatibility factors and technological expertise suggest that only one contractor exists."

3.47 We verified that PWGSC had posted an Advanced Contract Award Notice to ensure that potential bidders had the opportunity to challenge the decision to sole source the contract. We checked a sample of contracts and amendments and verified that the Department had followed the signing authority requirements. We reviewed exceptions made to the standard limitation of liability contract clause and found that PWGSC had complied with the associated requirements of Treasury Board risk management policy.

3.48 In November 2003, the original ECP-583 sub-contractor completed the sale of its division that had been responsible for the ECP-583 installations. We found that PWGSC demonstrated due diligence by ensuring that the assignment of the sub-contract to the new sub-contractor did not result in additional technical, financial, and legal risks to the government of Canada.

3.49 **Fairness monitor documentation.** PWGSC engaged a fairness monitor to review the solicitation and associated documents and to monitor the procurement process for the Advanced Distributed Combat Training System. We asked the Department to provide us with the fairness monitor's working papers and were informed that they did not have any. PWGSC explained that it does not require working papers because assurance is derived from the ongoing participation of the fairness monitor in the bid evaluation process and is supported by their professional qualifications and experience. However, in the absence of such documentation, we are unable to determine the level of reliance that we, or the Department, can place on the fairness monitor's observations.

3.50 **Status reports.** We also found that the requirement for reporting to senior management on contract status was not standardized. Of the five contracts, there were monthly progress reports for only two. Of the remaining three, one contract had not been signed yet, but we were told that reports would commence when the contract was awarded. We expected to find regular status reporting on more than two of the four signed contracts because of the interdependencies of the upgrades. However, PWGSC officials told us that the reporting requirement for each contract is "based on contract complexity and political sensitivity."

3.51 Despite a few concerns, we are satisfied that the Department has carried out its work in the contracting areas we examined in all material respects and in accordance with the Supply Manual.

Better project management required

3.52 **Better use of project management tools is necessary.** Because the CF-18 modernization is technically complex, very costly, and has many interdependent activities, we expected to find a mature project management process in place. However, we found that National Defence needs to better use project management tools to track progress, monitor performance against milestones, and determine appropriate staff resources.

3.53 The Project Management Plan, produced by project staff, is a key document in National Defence's project management framework. The

Department uses it to guide both project execution and project control. The Master Implementation Plan, produced by operational staff, directs modernization activities and guides the implementation of the modernized CF-18 into service with minimal impact on operations. These important documents provide an overall plan of schedules and deliverables, how the work will be done, performance expectations, responsibilities, training, communications, and certain financial aspects of the CF-18 modernization. We found that, although some of the individual elements were produced in different forms, a Project Management Plan was not produced due to a personnel shortage and the Master Implementation Plan remained in draft form until February 2004.

3.54 The project staff use project management software to maintain a CF-18 master schedule to monitor individual project schedules. However, the master schedule contains only the major activities for each of the individual projects; thus, its usefulness at the working level is limited. In addition, the master schedule does not identify baseline dates for project milestones and so deviations from the schedule cannot be tracked, measured, or reported to senior management.

3.55 The Treasury Board Secretariat has issued project management guidelines to departments to encourage good management practices. Departments need to use a suitable database system to track key objectives and numerical information, such as deviations from the schedule, cost, and scope objectives. National Defence has a Capabilities Initiatives Database to track how well projects are performing, but we found the information it contains is not always reliable and is easily changed to reflect actual rather than expected performance. As a result, it is not possible to measure whether a project is meeting expectations or if it needs help. Senior management cannot rely on the database to determine if projects are meeting milestones or where delays are occurring.

3.56 **Recommendation.** National Defence project management staff should prepare a project management plan that clearly indicates the critical path among projects and project activities to ensure the reporting of reliable project information to senior management and the appropriate application of resources to meet Phase 2 target completion dates.

National Defence's response. National Defence agrees. As part of Phase 1 of the CF-18 modernization, elements of an overall project plan were prepared and used to guide the project. The project team is now working on a consolidated and expanded master document. This document should serve to further enhance the management of the project as well as improve oversight by senior departmental officials.

3.57 **Staffing limitations.** The Department limits the number of military staff who can work on equipment acquisition projects to about 460, rather than matching the number of staff needed for active projects. The Assistant Deputy Minister (Materiel) organization is concerned that this number of staff is too low and may be putting equipment projects at risk. The Assistant Deputy Minister (Materiel) has started a study to fully understand skill and capacity gaps. The results of the study will be used to determine whether the ceiling should be raised.

3.58 Because of limits on staffing, the current military staffing system cannot ensure that project offices receive the right people, with the right skills, at the right time, to achieve optimal project management delivery. Project managers have no assurance that vacancies, even critical ones, will be filled by qualified candidates. The military staffing system depends upon the availability of personnel with the technical skills required by a particular project. For example, aerospace engineers were much in demand at the time of our audit; as a result, there were not enough experienced engineers to meet operational and project demands—including the demands of the CF-18 modernization.

3.59 Internal Department reviews in 2001, 2002, and 2003 note the lack of experienced staff for acquisition projects and enough staff overall. We found that staff shortages have existed since the CF-18 modernization began. We found only about half of the positions staffed, and the available staff did not always have the experience or skills needed. In order to cope, the Department has hired contract employees to fill voids.

3.60 On occasion, project staff assigned to work on Phase 2 were reallocated to help with Phase 1 in order to keep Phase 1 on track. Early on in the project, project staff expressed concerns to senior management that the CF-18 modernization was short staffed, and that the shortage would jeopardize Phase 1 and future work. Senior project staff report that the staffing situation may become worse for Phase 2.

3.61 **Training required.** Project management experience is not common and we found that about 80 percent of the CF-18 project staff arrived with little or no project management experience. Internal reports to the Assistant Deputy Minister (Materiel) group identified the lack of experienced staff as a serious problem facing many projects. Even though the Department's acquisition project offices are staffed mainly by military members, there is no long-term training path for developing project manager or director skills. National Defence needs a project management progression path so that staff can learn skills and be ready to apply them to large, complex projects such as the CF-18 modernization, rather than spending much of their project time learning about this. Staff could start by working on smaller projects to gain this experience and demonstrate their capacity to progress to larger, more complex projects.

3.62 **Recommendation.** National Defence should examine its support for large and complex projects to ensure that it is not limiting success by failing to provide skilled and experienced people with knowledge of good project management practices.

National Defence's response. National Defence agrees. The Assistant Deputy Minister (Materiel) continuously reviews and updates current project management training courses and, in addition, provides support to individuals who seek to acquire higher education and qualifications on their own initiative.

The Department also maintains a Project Management Office staffed by a limited number of project management specialists. The purpose of this office is to support capital projects, particularly new projects, and to provide assistance during prolonged absences of assigned project management personnel due to training, postings, or job rotations. Providing specialist support in the early phases of large and/or complex projects helps bridge the learning curve faced by newly assigned project management personnel.

The Department will further undertake to resource positions critical to the successful management of the CF-18 modernization. The Department continues to work to ensure flexibility of assignment of expert resources between projects as well as ensuring that common expertise is appropriately consolidated. In this respect, the Department's Chief of Review Services has been asked to perform an independent study and to make recommendations pertaining to the organization and allocation of project management resources and expertise.

National Defence and Public Works and Government Services Canada need to improve their risk management

3.63 **Risk management plan only recently produced.** We are concerned that a risk management plan was not developed at an earlier stage in the project to identify and manage risks to the successful completion of the CF-18 modernization. National Defence is at an early stage of risk management activity and only recently drafted its plan to track and manage risks.

3.64 **Relying on the contractor.** Public Works and Government Services Canada and the Treasury Board Secretariat relied on National Defence for the assessment of risk at the funding approval stage. National Defence, in turn, relied on the contractor who had identified their risk exposure as low. Therefore, all three organizations used a low risk rating for the CF-18 upgrades. As noted in the Treasury Board policy on project management, we expected National Defence and Public Works and Government Services Canada to be able to provide us with evidence to support the consultative process used to establish the government's low risk rating. For instance, we expected National Defence to have identified critical risks that could affect the project schedule, such as lack of staff, technical difficulties, or delays in validating and verifying the aircraft for acceptance and airworthiness. Similarly, we expected PWGSC to be able to provide us with documents to support the risks it had identified and how they had been mitigated through the various clauses within the related contracts.

3.65 We also expected to find a PWGSC risk management plan to address contractual risk, but the Department told us that it identified and dealt with potential risks on a continuing basis. The Department explained that a risk management plan must be produced by the contractor; therefore, the plan provided by the contractor is the formal government document.

3.66 **Criteria.** We evaluated the risk management practices at National Defence and PWGSC through two sets of criteria. The first set was made up of six risk management themes drawn from the Project Management

Institute. The Treasury Board had adopted these themes as department policy for ensuring the use of sound project management principles, including risk management practices. The second set of criteria is made up of federal and departmental risk management policy requirements that are specific to the entity audited. We gathered the results of these evaluations through interviews and document reviews.

3.67 We found that while National Defence and PWGSC met some of the criteria for good risk management, none were met fully. Both departments need to improve risk management in each of the six areas shown in Exhibit 3.5.

Exhibit 3.5 The six themes for evaluating risk management

We evaluated the risk management practices of the Department of National Defence and Public Works and Government Services Canada using the following criteria:

- **Risk management planning.** Did the entity plan properly and ensure that the level and type of risk management activity match the risk and importance of the project.
- **Risk identification.** Did the entity identify and document potential project risks.
- **Qualitative risk analysis.** Did the entity assess the impact and likelihood of the occurrence of the identified risk.
- **Quantitative risk analysis.** Did the entity determine how often each risk might occur and the consequences on project objectives.
- **Risk response planning.** Did the entity undergo the process of developing options and actions to enhance opportunities and reduce threats to the project's objectives.
- **Risk monitoring and control.** Is the entity identifying, monitoring, and dealing with risk across the project on a continual basis.

Source: Project Management Institute

3.68 **Treasury Board Secretariat oversight.** Treasury Board Secretariat officials informed us that they oversee the CF-18 modernization to ensure the integrity of the expenditure process. They stated that they also ensure that National Defence identifies and assesses project risks and puts in place measures and strategies to deal with risks, but they don't manage the risks associated with individual projects.

3.69 The Treasury Board Secretariat did not provide us with evidence to support its review of National Defence's identification and assessment of project risks for the ECP-583 project. Secretariat staff told us that they attended the National Defence ECP-583 briefings and that this demonstrated due diligence in its oversight role. While attending National Defence briefings does represent some oversight, we also expected the Secretariat to provide evidence supporting the other work they do in carrying out their oversight role.

3.70 We found that the availability of such supporting evidence started to increase in 2003. We particularly note that the government recently approved a CF-18 project on the condition that National Defence submit annual reports. Annual reports for all CF-18 projects are now to highlight progress on milestones and any changes to scope, and they should include an updated risk assessment. We view this as a positive step.

Impact on Phase 2

Risks to Phase 1 threaten timely completion of Phase 2

3.71 In Phase 1, the contractor for the major project—the ECP-583—had already successfully installed and tested it on the F/A-18 fleets of two other nations. National Defence was able to take advantage of a ready-to-go package for the integration of mature avionic systems that the contractor had developed for the U.S. Navy. Phase 1 required National Defence to address unique technical modifications, co-ordinate testing, and develop integrated logistic support, among other things.

3.72 Phase 2 involves the installation and integration of systems that have not been in production as long as the Phase 1 systems. The ECP-583R2 consists of the integration and installation of Data Link, multi-purpose displays, helmet mounted displays, and upgrading of the Counter Measures Dispensing System (Exhibit 3.2). The CF-18 software will also be upgraded. At the time of the audit, work was being done on Data Link and the multi-purpose displays to integrate them with the CF-18s. In order for the contractor to start the Phase 2 production line as the Phase 1 line finishes, Phase 2 was following an aggressive schedule.

3.73 Department officials told us that the risks for the ECP-583R2 could be higher than the ECP-583, but National Defence still assessed it as low. Project staff were developing plans to manage risk. The departmental approval process for the ECP-583R2, originally planned for fall 2004, was delayed. The Department now anticipates awarding the contract in early fall 2005. If approval for the ECP-583R2 is further delayed, there is little room to adjust to keep the modernization on track.

3.74 **Funding issues must be resolved.** Originally, a new Defensive Electronic Warfare Suite, which consisted of a counter measures dispensing system, a radar warning receiver, and an electronic pulse jammer, was to be installed on the CF-18. The full Suite would equip the CF-18 for operations in a high-threat scenario. However, at the time of the audit, only the counter measures dispensing system portion of the Suite was included as part of the ECP-583R2 in Phase 2. The radar warning receiver and the jammer did not proceed through the approval process due to funding issues. Defence officials told us that the CF-18s would not be deployed to a high-threat scenario without a full Suite, subject to government direction. National Defence plans to have a full Suite in its CF-18s by 2009.

Other pressures

National Defence needs to resolve resource issues

3.75 We found that there are concerns outside the scope of the CF-18 upgrades that could threaten the overall success of the modernization. They need to be addressed to ensure full use of the aircraft until the end of its useful life.

3.76 **Technicians**. National Defence is experiencing a shortage of skilled aircraft technicians. Because of the lack of technicians, maintenance work is taking longer, which means that aircraft turnaround times have increased. The longer the turnaround time, the fewer the possible sorties and available flying hours for pilots in training. Demographic indicators show that this problem may get worse as older technicians retire, leaving more inexperienced technicians to maintain the aircraft.

3.77 To ensure that aircraft do not degrade because of a lack of proper maintenance, National Defence must have the technicians and the spare parts available when needed. It was not clear at the time of this audit what the projected use of spare parts would be for the modernized CF-18 and whether there were sufficient spare parts to meet demand. The Department has begun developing a Logistics Management Plan to forecast requirements.

3.78 **Pilots.** Pilot shortages are a challenge that we reported on in the past. We were informed that because of pilot shortages last year, the Air Force was not able to use all of the available flying hours for the CF-18s. To ensure that the 80 upgraded aircraft are used fully, National Defence must have enough trained and available pilots to fly the missions. Pilot shortages are felt particularly at the training units, which often suffer first when there are not enough experienced pilots for both squadron operations and training unit demands.

3.79 The Department caps yearly flying hours at 182.7 per pilot, which is sufficient to maintain proficiency for a medium-threat scenario. Pilots no longer train for high-threat scenarios, which require about 240 flying hours per year. With the introduction of simulators in 2005, training personnel envision that additional operational training objectives may be met.

3.80 **Funding.** The ability of National Defence to sustain and support established CF-18 operational capability and capacity in the future may be affected by the resources available. National Procurement funding is used for spare parts and repairs and overhaul contracts; however, funding uncertainties have an impact on the ability of the Department to plan. The spring 2004 Aerospace Management Committee indicated that there is a projected gap of $100 million between the Air Force funding demands and available National Procurement funds. As well, the Committee projects a decrease in National Procurement funding such that by 2007–08, available funds will be about 65 percent of identified demand. This may introduce uncertainty and volatility in the Department's ability to maintain and continue flying the CF-18s to meet operational commitments.

3.81 **Recommendation.** National Defence should ensure that sufficient funding is allocated to support the CF-18 and that a sufficient number of trained technicians and pilots are available to maximize the value of the investment in the CF-18 modernization.

National Defence's response. National Defence accepts the recommendation and will continue to analyze resource requirements on an annual basis to optimize resource allocation. The CF-18 fleet will be allocated a portion of National Procurement funding based on forecast maintenance and support in order to optimize utilization and achieve value for money relative to the costs of the modernization project. Furthermore, we recognize the importance of ensuring that the value of the investment in the CF-18 modernized fleet is maximized. To that end, additional funding has been allocated to increase the number of technicians produced by our training process and, as a longer-term solution, an initiative entitled Air Technician Training Renewal is commencing.

The production of a pilot is a complex and multi-faceted process that includes recruiting; training at the basic, advanced, and operational levels; and combat ready training at an operational squadron. At the end of 2003, a multi-million dollar recruiting campaign was directed at, among other things, potential pilot candidates. In conjunction with this initiative, the Air Force is currently in the process of developing better selection tools to improve the likelihood that potential candidates will be successful during their training. In addition, new measures are also under consideration with a view to retaining more of our qualified pilots.

Conclusion

3.82 Phase 1 of the CF-18 Incremental Modernization Project is the result of a process that reasonably links mission requirements to the upgrades undertaken. The five projects we reviewed were all progressing within cost; however, two of the five projects were behind schedule. The upgraded aircraft were being delivered on schedule and, according to National Defence, were meeting its performance expectations.

3.83 Public Works and Government Services Canada has managed the critical parts of its contracting responsibilities. However, it could better document the work it carries out as the government's contracting agent.

3.84 Although we found it difficult to obtain the documentary evidence to support the Treasury Board Secretariat's oversight role in the early stages of Phase 1, since 2003, when evidence concerning the performance of its oversight role became more readily available, we concluded that the Secretariat was carrying out an oversight role.

3.85 Improvements to project and risk management are needed before National Defence continues with the Phase 2 upgrade projects. There are impediments to the successful outcome of Phase 2 that can be addressed by a review of staffing, better project control through planning and reporting, a better understanding of risk management, and implementing the risk management plan it now has. If these areas are not addressed, the Department is putting at risk its ability to get full value from its $2.6 billion investment in the CF-18.

3.86 There are also factors outside the direct scope of the CF-18 modernization project that need to be addressed by the Department to ensure that it attains the full investment value of upgrading the CF-18s. The Department needs to address the personnel shortages that threaten its ability to fly the CF-18s and keep them properly maintained. As well, it needs to resolve support funding issues.

About the Audit

Objectives

The overall objective of our audit was to assess whether the CF-18 Incremental Modernization Project is being effectively managed.

To do this, we addressed whether

- National Defence effectively identified a valid capability need;
- the Department managed the project within performance, cost, and schedule expectations;
- Treasury Board of Canada staff provided adequate initial scrutiny of submissions and whether their monitoring and oversight, given the resulting projects, match the risk, materiality, and technical complexity of the projects;
- Public Works and Government Services Canada managed the contracting portion of the defence acquisition effectively such that the contracting process complies with government policy and contracting regulations and that for processes under its control, the project has remained within performance, cost, and schedule expectations; and
- the project met or will meet the standards associated with effective planning, including training, maintenance, materiel support, and risk management

Scope and approach

We carried out our audit primarily at National Defence headquarters and included visits to the 4 Wing fighter base in Cold Lake Alberta, 1 Canadian Air Division, and the modernization facility in Mirabel, Quebec.

The audit team interviewed personnel from National Defence, PWGSC, and the Treasury Board Secretariat. We examined department files, relevant documents, and reviewed the experiences of other countries who modernized their fighter aircraft.

When we planned this audit in the summer of 2003, the sub-projects and projects contributing to the modernization of the CF-18 consisted of two phases, Phase 1 (2001–06) and Phase 2 (2004–09).

The five Phase 1 projects:

- mission computers
- operational flight program
- Engineering Change Proposal 583
- multi-purpose displays group units
- Advanced Distributed Combat Training System

Audit criteria

The criteria for the audit included the extent to which

- National Defence conducted adequate requirement and option analyses to ensure that it is acquiring or upgrading a valid capability need;
- the Department undertook risk analysis to identify and manage risks;
- test and evaluation processes are sufficient to ensure that the capability delivered meets the original specifications;
- National Defence and PWGSC followed government contracting policy and regulations;
- equipment implementation plans are comprehensive enough to ensure the most efficient and effective introduction of the equipment into operations, including optimal equipment availability, support, maintenance, and training throughout the equipment's life cycle; and

- National Defence gave due consideration to, and introduced, acquisition reforms where appropriate at all internal levels as they related to the selected project.

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Report of the Auditor General of Canada to the House of Commons—November 2004

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2004

Report of the
Auditor General of Canada
to the House of Commons

NOVEMBER

Chapter 4
Management of Federal Drug Benefit Programs

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

4

Management of Federal Drug Benefit Programs

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Management of Federal Drug Benefit Programs

Main Points

4.1 Our audit of the federal government's drug benefit programs found a lack of leadership and co-ordination in the provision of drug benefits. The six federal organizations that administer the programs approve most of the same drugs and deliver them through the same pharmacy system in Canada. However, the failure to co-ordinate their efforts has led to missed opportunities to save money and contain costs.

4.2 Studying drug use patterns, and taking appropriate action, can prevent the misuse of drugs and help ensure that clients realize the intended health outcomes of drug benefit programs. The federal government has current, highly informative data on the drug use of each of its clients; however, these data are not being systematically assessed and disseminated to health care professionals. The data provide an important source of medically relevant information for Health Canada, Veterans Affairs, the RCMP, and National Defence, all of whom share responsibility for improving or maintaining the health of their respective clientele, in partnership with industry and service providers. Failure to share this information could result in less than optimal health outcomes for many clients.

4.3 In managing these programs, federal organizations have not taken advantage of known cost-saving opportunities in order to ensure the programs' long-term sustainability. As a result, the government may be spending tens of millions of dollars annually more than necessary.

Other observations

4.4 The federal government is the fourth largest payer of prescription drug benefits in Canada, after Ontario, Quebec, and British Columbia. It spends more than $430 million annually on prescription drugs for about one million Canadians. These costs have risen by 25 percent over the past two years.

4.5 Other than for cost, most federal organizations have neither objectives nor performance measures that are specific to their drug benefit activities. Without specific objectives and related performance information, organizations have no means of assessing whether their activities are meeting intended purposes and are cost-effective.

4.6 Audits of pharmacies have identified significant overcharges owed to the Crown. These amounts owing have not been recorded in the Public Accounts of Canada as required by the Treasury Board Policy on Receivables Management.

The government has responded. Federal organizations agree with all of our recommendations and their responses are included in this chapter. The government has told us that details on actions to be taken will be communicated to us within a few months.

Introduction

4.7 The use of pharmaceutical drug products is a fact of life for many Canadians. These products prevent and cure diseases, help to manage chronic medical conditions, and provide relief from many regular aches and pains. Over the past 40 years, drug products have fundamentally changed the face of health care in Canada and will continue to play a prominent role in the years to come.

4.8 The manufacture, distribution, and sale of drug products form a multi-billion-dollar industry in Canada. In 2003, an estimated $19.6 billion was spent on them—the second largest component of all health care spending in Canada, after hospital expenditures.

4.9 Pharmaceuticals are not insured under the *Canada Health Act*, except for drugs dispensed in facilities providing hospital care. While many Canadians must pay for their prescription drugs themselves, some are covered by private or corporate drug benefit plans or by provincial or federal government programs.

4.10 About one million Canadians are eligible for federal drug benefits. The programs providing the benefits have been among the fastest-growing areas of federal spending on health. Between 2000–01 and 2002–03, spending on these programs grew from $350 million to $438 million, a 25 percent increase in just two years. The federal government is now the fourth largest payer of drug benefits in Canada, after Ontario, Quebec, and British Columbia.

4.11 Collectively, provincial governments are estimated to provide benefits to over nine million Canadians. We conducted this audit in co-operation with provincial auditors general, most of whom plan to report the results of their audits to their respective provincial legislatures in the coming months.

Focus of the audit

4.12 This audit examined the drug benefit programs of six federal organizations: Health Canada (benefits for First Nations and Inuit), Veterans Affairs Canada (veterans), National Defence (Canadian Forces members), the Royal Canadian Mounted Police (members), Citizenship and Immigration Canada (certain designated classes of migrants), and Correctional Service Canada (inmates of federal penitentiaries and some former inmates on parole).

4.13 Although our audit work included following up on audits completed between 1996 and 2000 in Health Canada and Veterans Affairs Canada, most of our work focussed on more recent activities. A summary of our follow-up conclusions is in the Appendix. More details on the objectives, scope, approach, and criteria are included in **About the Audit** at the end of the chapter.

Observations and Recommendations

Program features

4.14 There are important distinctions among the six federal programs. Citizenship and Immigration Canada, for example, provides drug benefits to clients for a relatively short period, averaging one and a half years, and this clientele varies significantly throughout the year. In contrast, Health Canada provides drug benefits to its clients throughout their lives. The relationship of organizations to clients also differs significantly, from provision of basic medical services by Correctional Service Canada during clients' confinement to provision of long-term care and living assistance by Veterans Affairs Canada. National Defence and the RCMP provide drug benefits, in part, to ensure operational effectiveness. The costs of providing such drug benefits in 2002–03 ranged from $5 million at Citizenship and Immigration Canada to $290 million at Health Canada. Exhibit 4.1 summarizes the size of each program. Although the drug benefit programs are as different as the mandates of the six federal organizations we audited, they approve many of the same drug products and are similar in several respects (Exhibit 4.2).

Drug benefit process involves several parties

4.15 Federal organizations are not alone in delivering these services. They must work with other stakeholders, including doctors, pharmacists, provincial governments, and claims administrators under contract to the government. Doctors have an important responsibility for patient care and are normally paid a professional fee by provincial governments for any medical assessment associated with the prescription of a drug. Pharmacists are normally responsible for dispensing drugs, while both doctors and pharmacists are responsible for ensuring that different drugs prescribed to patients (sometimes by different doctors) do not interact in a negative way. Pharmacists also play vital roles in counselling patients and recording information on the various drugs prescribed to a patient, including information provided by the patient or the prescribing doctor. Pharmacists bill the respective federal drug programs for the prescriptions they fill, including the costs of the drugs and their professional dispensing fee. A claims administrator under contract with the federal government usually makes the actual payment and is reimbursed for its costs as well as a service fee for each transaction. Patients also play a role in their own health care.

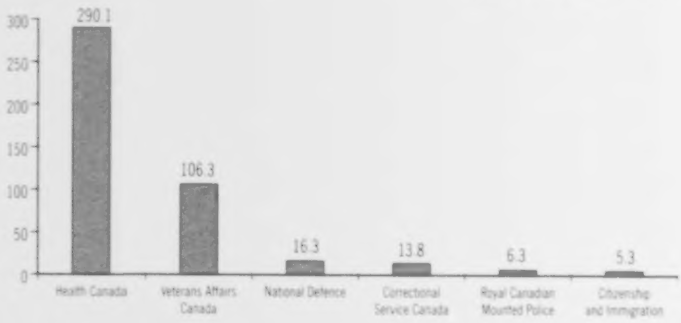
Objectives, performance measures, and reporting

4.16 Program objectives state the purpose or benefits of an organization's activities. Performance measures provide information about the program's progress toward each objective, and their use can help to inform management and other decision makers when corrective action is needed. Our Office and the Treasury Board Secretariat have long emphasized the importance of setting clear program objectives and measuring performance toward achieving them. Without objectives and performance measures, it is often difficult to determine the most effective strategies for achieving results.

Exhibit 4.1 Size and cost of drug benefit programs, 2002–03

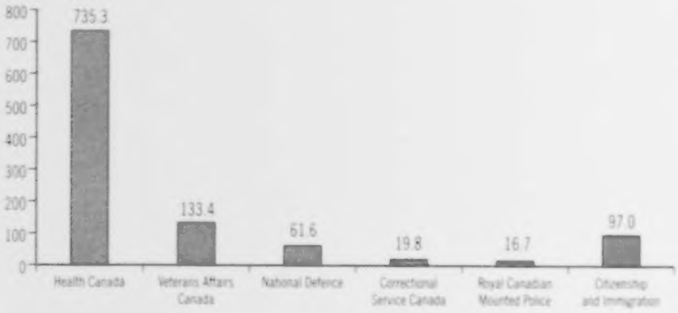
Expenditures ($ millions)

Total expenditures are $438.1 million



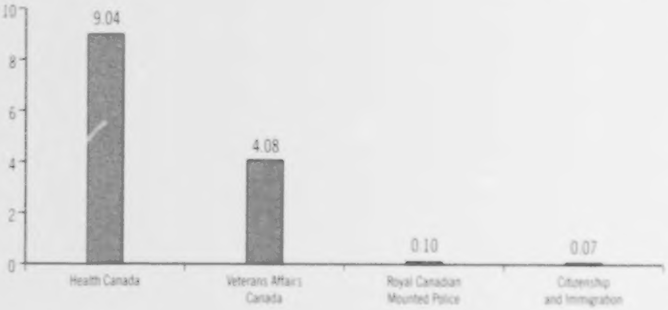
Recipients (thousands)

Total eligible recipients are 1,063.8 thousand



Prescriptions (millions)

Total prescriptions are 13.29 million



Consequently, program managers may fund activities that are ineffective and not necessarily meeting the needs of their clients.

4.17 Given the size and costs of the federal drug benefit programs, we expected that each program would have clearly stated objectives and

Exhibit 4.2 Similarities of the six federal drug benefit programs

- Most programs have the goal of optimizing the health status of its clients.
- Most program clients obtain prescriptions from their doctors and drugs from pharmacies.
- The programs' clients typically do not pay for their drugs; the federal government reimburses the pharmacies.
- Program costs for providing drug benefits have increased significantly in recent years.
- Most programs use third-party claims administrators to manage payment of benefits.
- Programs provide benefits for many of the same drug products.
- Most programs keep detailed information on their client transactions.

performance measures. We also expected that objectives would focus on improved outcomes, reflecting the positive therapeutic effects of drugs and the value that taxpayers are obtaining for their tax dollars. Finally, we expected that performance information would be reported to Parliament.

4.18 **Drug benefit programs are part of larger programs.** In all cases, we found that the provision of drug benefits is a component of larger health care programs, each with its own set of general health objectives. Therefore, we asked each of the six federal organizations to provide us with the drug benefit objectives and performance measures being used in the assessment of their larger programs. We also reviewed internal documents that we expected would include such measures and performance reporting where warranted.

4.19 We found that the objectives for the organizations' health-related programs do not include objectives specific to drug benefits in most cases. Health Canada, National Defence, and Citizenship and Immigration Canada had objectives specific to the costs of their drug benefit activities. Although the RCMP, National Defence, and Health Canada have program objectives for their larger programs for which the monitoring of drug use could serve as a performance measure, only National Defence has analyzed its data for such purposes. For example, National Defence has performance measures to track objectives related to operational readiness and, in fact, it routinely collects and analyzes data related to the availability of essential medication and its provision to personnel in operational settings.

Decision making is not based on performance data

4.20 Collective or individual objectives and associated performance measures for providing drug benefits are necessary in order for management to assess whether their related activities are meeting their intended purposes and are cost-effective. They are also needed to assess how the provision of drugs contributes to achieving their broader program objectives. However, most organizations do not have the information they need for decision making or for reporting on the progress of their drug benefit activities toward their planned outcomes. In particular, management should be able to decide which drugs are to be maintained, added, or deleted from their drug list. This decision should be based on their own performance information such as actual cost-benefit data. However, other than National Defence, organizations do not regularly analyze such information for this purpose.

4.21 **Recommendation.** Health Canada, Veterans Affairs Canada, National Defence, the RCMP, Citizenship and Immigration Canada, and Correctional Service Canada should, either collectively or individually, establish or strengthen objectives and performance measures for their drug benefit activities and report to Parliament as appropriate.

Organizations' response: Agreed. Federal organizations will establish or strengthen drug benefit program objectives and performance measures appropriate to their client populations and mandate. All actions will support the National Pharmaceutical Strategy commitments made by First Ministers. Departments will report regularly on progress.

Analyzing drug use trends

Claims processing databases provide valuable information

4.22 Analyzing how drugs are being used is critical in supporting the provision of good health care. Studying drug use patterns and taking appropriate action to prevent the misuse of drugs can help ensure the intended health outcomes of drug benefit programs. Five federal organizations capture all individual client transactions on databases. These databases may constitute a unique source of information on about one million Canadians and 13 million individual drug transactions per year, including the names and quantities of drugs prescribed, the respective dates, and associated costs. Experts from government, academia, and U.S. pharmacare consider the analysis of this information to be an important element in the management of pharmacare programs and believe that such analysis can have a significant impact on the quality of health care. These databases are important sources of medically relevant information for Health Canada, Veterans Affairs Canada, the RCMP, and National Defence, all of whom share responsibility for improving or maintaining the health of their respective clientele, in partnership with doctors and pharmacists.

- **Health Canada.** In its 2002–03 Annual Report on the Non-Insured Health Benefits Program, Health Canada states, "The purpose of the program is to provide non-insured health benefits to First Nations and Inuit people in a manner that contributes to the achievement of an overall health status for First Nations and Inuit that is comparable to that of the Canadian population as a whole."
- **Veterans Affairs Canada.** The Veterans Affairs Canada Adverse Drug Utilization Review Policy states, "The focus of Utilization Review is to ensure that appropriate health care is received by members and rendered by physicians and pharmacists. This is achieved by assessing whether benefits received under the program result in optimum health outcomes for members. Medical and health-based analyses are performed with the focus on members' wellness. The goal is to alert

health care providers to situations of adverse benefit use by supplying them with specific details of the member's utilization patterns."

- **RCMP.** In its 1998 Strategic Plan, the RCMP indicated its commitment to medical surveillance: "Because of concern about these safety issues and, also, because of the enormous potential liability that would result from failure to apply due diligence to prevent resultant damage to life or property, the Force has a legal and ethical duty to ensure that members are fit to safely perform the tasks of police work."
- **National Defence.** National Defence has two relevant objectives for analyzing drug use: to enable the provision of patient care through judicious use of medicines; and to administer a drug program based on four principles—operational readiness, fairness, equality, and health outcomes.

4.23 Given this policy orientation, we expected these four organizations to routinely conduct analyses of drug use and communicate all relevant information to health care decision makers to assist them in optimizing the health care outcomes of their respective clients.

4.24 Correctional Service Canada and Citizenship and Immigration Canada have limited programs that provide only basic health care services and, as such, we did not expect substantial analyses of their drug use databases.

4.25 The data from the claims processing databases can be used for two types of drug use analyses: concurrent analyses and retrospective analyses. Concurrent analyses identify potential sources of therapeutic problems at the time prescriptions are dispensed. In this regard, alert fields can be programmed into the systems that advise pharmacists if filling a prescription could put a patient's health at risk (for example, when two drugs may react negatively with each other). Retrospective analyses examine drug use patterns over defined periods for individual clients and groups of clients considered at risk.

4.26 **Concurrent analyses.** As the claims processing databases constitute the only comprehensive source of data on drug use for many clients, this information is very important to health care decision makers. Access to these data is especially crucial for certain client groups, such as the more than 166,000 seniors and thousands of diabetics served by federal drug benefit programs.

4.27 In our 1997 audit, Chapter 13, First Nations Health, and in our 2000 follow-up, we reported that clients were accessing large numbers of prescription drugs. In 1997 we recommended that Health Canada's automated system alert pharmacists to potentially inappropriate drug use in order to facilitate timely intervention. We also expected that organizations with a large number of senior citizen clients, such as Veterans Affairs Canada, would routinely analyze their data for drug use patterns that are known to put senior citizens at risk.

Claims processing systems do not detect many types of potential abuse

4.28 Health Canada's system provides pharmacy alerts for duplicate drug therapy and drug-to-drug interactions. This information is routinely captured in the Department's claims processing database. Pharmacists can choose to override these alerts after they have consulted with a doctor, the patient, or other sources and are satisfied with the explanation.

4.29 In our 2000 audit of Health Canada's drug benefit program, we recommended that the program more closely monitor pharmacists' overrides of warning messages for drug use and undertake rigorous and ongoing analysis to assess the effectiveness of the messages. The Department took appropriate action and reported the analysis of pharmacy overrides and action taken.

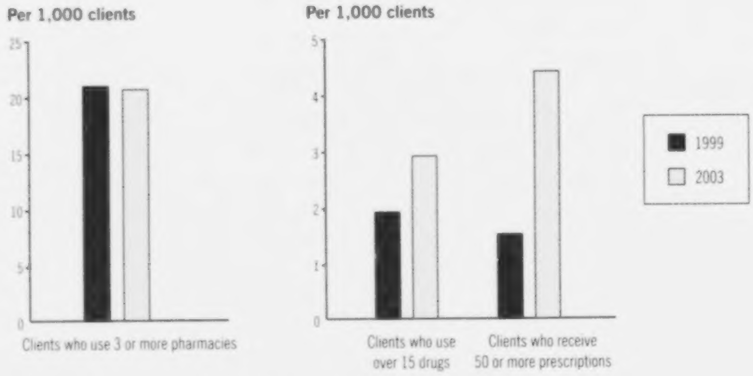
4.30 In 2002–03, the Department's claims processing system rejected about 300,000 claims of the more than nine million drug transactions. Of these rejections, 83,000 (28 percent) were overridden and paid by the program. About 70 percent of the overridden claims were for duplicate prescriptions claimed in the same pharmacy; 43 percent of these were based on the client providing an adequate explanation to the pharmacist before the prescription was filled. This system is now used to assist Health Canada in identifying pharmacies for audit.

4.31 Veterans Affairs Canada set up a claims processing system in 1997–98 that also identifies duplicate drug therapy and drug-to-drug interactions at the time of dispensing. Unlike Health Canada's system though, it also identifies cases where multiple narcotics are being dispensed for the same client. However, it issues an alert only for drugs that have been previously dispensed from another pharmacy. It does not issue alerts for intrapharmacy claims; these are left to the discretion of the pharmacist. Thus, Veterans Affairs Canada does not collect override data for duplicate prescriptions claimed by the same pharmacy. Nor does the Department collate information on claims processing alerts or assess the volume of alerts and overrides, and the reasons for the overrides.

4.32 Citizenship and Immigration Canada does not yet have an automated alert system and does not collect override information as its automated system is still being developed. Correctional Service Canada and National Defence do not maintain alert and override systems for internal operations, given the highly controlled nature of their operations.

4.33 **Health Canada and Veterans Affairs Canada clients access large numbers of prescription drugs.** In our 1997 Report, Chapter 13, Health Canada—First Nations Health, and the follow-up in 2000, we identified potential abuse by clients from the over-prescribing of drugs. We repeated this analysis in this audit. As shown in Exhibit 4.3, we found that the number of clients accessing 50 or more prescriptions had increased significantly compared with the number we observed in our 2000 audit (corrected for population growth). Health Canada was unable to explain why the number of such clients had almost tripled in four years.

Exhibit 4.3 Health Canada—Key indicators of excess prescription drug use*



*Based on data for period July to September 1999 and 2003

4.34 In its 2001 report pertaining to our 2000 audit, the Public Accounts Committee recommended that Health Canada immediately upgrade its system to provide pharmacists with the names and quantities of drugs prescribed and the respective dates for at least a client's last three prescriptions, as well as relevant details on the doctor visited. As noted in the Appendix, this recommendation has not been implemented.

4.35 We also analyzed departmental data for July–September of 2003 for four of the six federal organizations we examined (Exhibit 4.4). The data showed that a considerable number of Veterans Affairs Canada and Health Canada clients were taking more than 15 different drugs during this 90-day period and that a significant number had received 50 or more prescriptions during the period. We found that both departments' claims processing systems do not send alerts to identify clients accessing large numbers of drugs.

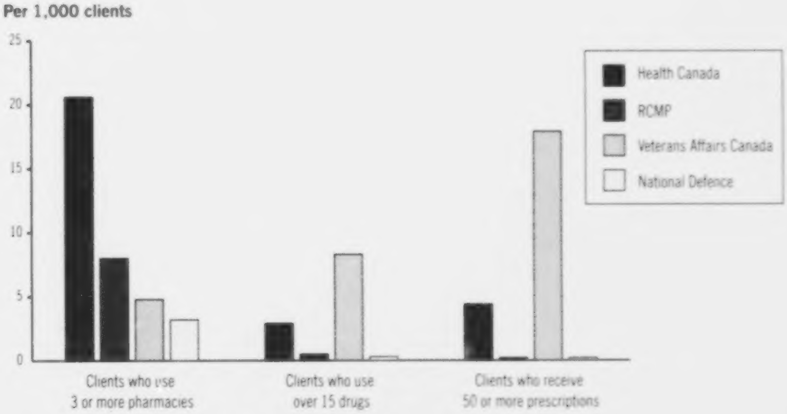
Narcotics—A class of drugs that are normally opium derivatives but also includes restricted drugs such as cocaine and marijuana. For the purpose of this audit, the term "narcotics" refers only to opioid narcotics such as morphine, codeine, and oxycodone, which are used to relieve pain. Excessive dosage of these drugs may cause unconsciousness, coma, and even death. Repeated use may cause physical dependency and, in certain individuals, addiction.

4.36 Clients obtaining multiple narcotics. Narcotics have a high potential for misuse. As such, we expected the organizations' claims processing systems to be more sensitive to the potential for misuse and provide pharmacists with immediate alerts for unusual opioid narcotic prescription patterns that suggest the need for further investigation.

4.37 To determine if the systems discourage the abuse of such drugs, we identified clients obtaining multiple narcotics using prescriptions from multiple doctors through multiple pharmacies. Experts in this field consider that clients acquiring two or more different narcotics through a combination of two or three doctors and two or three pharmacies should be considered at risk for drug misuse; clients with combinations of 11 or more doctors and 11 or more pharmacies in a year should be considered at high risk for problematic use of such medications, including misuse and addiction.

4.38 We found that in 2002–03 over 900 clients from the four programs analyzed were on two or more different narcotics simultaneously and had

Exhibit 4.4 Organizational comparison—Key indicators of excess prescription drug use*



*Based on data for period July to September 2003

acquired these drugs through prescriptions from two or more doctors and two or more pharmacies. Health Canada had 128 medium- and 94 high-risk clients receiving multiple narcotics simultaneously through a combination of seven or more doctors and seven or more pharmacies (Exhibit 4.5). While some cases may be attributable to terminally ill patients receiving end-of-life care, many patterns were highly suggestive of problematic use, such as drug misuse, addiction, and possibly trade or sale. For example, we identified a number of Health Canada clients who were dispensed large quantities of four or more different narcotics through up to 46 different combinations of doctors and pharmacies; one client was able to regularly acquire large quantities of seven different narcotics through 29 different doctors and 21 different pharmacies in one year (974 tablets each containing 30mg of codeine were obtained for three of these narcotics in one month). We also analyzed the use of benzodiazepines and found similar results. We found that Veterans Affairs Canada's claims processing system provides immediate alerts to pharmacists for the use of multiple narcotics and for the use of multiple benzodiazepines. Heath Canada's system does neither.

Benzodiazepines—So-called "minor" tranquilizers and depressants that relieve anxiety and produce sleep. In certain individuals, they can lead to addiction if taken for an extended period of time. Adverse effects include confusion, drowsiness, hallucinations, mental depression, and impaired co-ordination.

4.39 We also examined the concurrent use of methadone and other opioid narcotics by Health Canada clients to further test the Department's claims processing alert system. Expert advice received from the Centre for Addiction and Mental Health indicates that under appropriate professional supervision, methadone can be used (though not exclusively) to treat drug addictions involving opioid narcotics, such as heroin, morphine, and hydromorphine. In such cases, however, the concurrent use of methadone and other opioid narcotics is normally discouraged. Furthermore, a methadone maintenance program is intended to be a highly structured treatment model that requires careful oversight and close monitoring by both doctors and pharmacists in order to safely treat a complex group of patients with a minimum of risk to the patients and public.

Methadone—A long-lasting synthetic opioid used to treat pain and/or opioid addiction. In some cases, methadone can be effectively used to treat both conditions.

Exhibit 4.5 Risk levels for clients using opioid narcotics (excluding methadone), 2002–03

Organization	Number of clients at specific risk levels			
	Minimum	Low	Medium	High
Health Canada	45	135	128	94
Veterans Affairs Canada	446	39	6	1
RCMP	57	8	0	0
National Defence*	12	1	0	0

*2003–04

Risks for clients obtaining two or more narcotics:

Minimum—two or three doctors and two or three pharmacies
Low—four to six doctors and four to six pharmacies
Medium—seven to ten doctors and seven to ten pharmacies
High—over ten doctors and over ten pharmacies

4.40 Expert advice also points out that methadone is an unusual drug in terms of regulations surrounding its use. It is unique in that while it is particularly effective for the treatment of opioid addiction, it is also very effective for pain management. In many countries, including Canada, methadone use for the treatment of opioid narcotic addiction is highly regulated and requires a special federal permit (exemption) that is typically given only after advanced training by the prescribing physician. When methadone is used to treat pain, the permit does not require additional formal training. Likewise, there are currently no specific guidelines in place to assist prescribers in the ways to safely use methadone for the treatment of pain. As a result, it is possible for patients who would benefit from the highly structured and supportive care offered by methadone maintenance treatment programs to treat opioid addiction to seek treatment through less structured pain management programs. When methadone is used to treat two different and sometimes co-occurring conditions under two completely different regulatory models, the need to closely monitor its use becomes even more important since the risk of misuse is significant.

"In cases where clients are obtaining multiple controlled substances from different doctors, the likelihood of each prescriber being aware of the prescriptions for controlled substances by the other practitioners is reduced and decreases as the number of prescribers increases."

Dr. Douglas Gourlay, MD, MSc,
FRCPC, FASAM
Centre for Addiction and Mental Health
Wasser Pain Management Centre,
Mount Sinai Hospital

4.41 Therefore, we expected Health Canada's system to identify and flag for pharmacists the dispensing of opioid narcotics to clients who were also receiving regular methadone treatment for opioid narcotic addiction, particularly when prescribed by different doctors and subsequently dispensed by different pharmacists.

4.42 In 2002–03, Health Canada had 1,253 clients using methadone; 967 were in a methadone program for at least 60 consecutive days and, of these clients, 299 were concurrently prescribed one or more opioid narcotics. We found that more than 70 percent of these 299 clients had different doctors prescribe either opioids or methadone and 52 percent used a different pharmacy for each drug. Clients, who receive opioid narcotics from doctors other than those who prescribed methadone, especially without the methadone prescriber's knowledge, can be considered at high risk for drug misuse and, ultimately, program failure. Health Canada's claims processing system does not provide pharmacists with alerts when dispensing opioid narcotics to clients also receiving methadone. If such clients were identified early through effective alert systems, appropriate interventions could be initiated and treatment outcomes improved.

Programs are data-rich but information-poor

4.43 **Retrospective analyses.** The claims processing databases offer a wealth of information that can provide valuable insights into health trends of clients, the success of specific program efforts, and, to some extent, the appropriateness of drug benefits provided to clients. As a minimum, we expected organizations with large programs to conduct routine systematic analyses of these databases, both to evaluate the overall effectiveness of their programs and to improve the health outcomes for their clients.

4.44 We found that these large organizations do not use the substantial information in their database to consistently and systematically look for patterns of inappropriate use. Though not comprehensive, Veterans Affairs Canada's retrospective drug utilization review does target methadone use, monthly codeine use, the top 20 users of over-the-counter drugs, and the top 20 users of prescription drugs. When an extreme case of adverse use is identified, the Department's policy is to send letters to doctors and pharmacists and to mobilize a district health care team. The team consists of a medical officer, nurse, counsellors, and whatever outside expertise and resources are needed to assist the client, including drug addiction services and pain management clinics. The Department's drug use policy manual states that a "signed consent form is not necessary prior to sending provider notifications as this process is viewed as a service performed in the member's best interest and to protect their health." While this manual also states that Veterans Affairs Canada is to review historical information such as drug-to-drug interactions, the Department does not systematically conduct comprehensive risk analyses of this nature to determine patterns of inappropriate drug use; nor is such information communicated to health care professionals.

4.45 Other organizations conduct limited drug use analysis. Effective 2004, National Defence introduced a system to capture all pharmaceutical information pertaining to transactions both on- and off-base. Prior to this, its efforts were limited to reviewing adverse drug events identified in the literature and case reports on individual adverse reactions. These reviews led to a number of in-depth studies to evaluate specific drug use issues and often led to changes in drug use policies. The RCMP conducts drug utilization review for a small set of drugs that would potentially threaten the operational readiness of members, including psychoactive drugs, cardiac drugs, anti-convulsant drugs, and insulin.

4.46 In previous audits reported in 1997 and again in 2000, we recommended that Health Canada identify significant patterns of inappropriate use of prescription drugs and follow up with doctors, pharmacists, and professional bodies. We noted in our audit in 2000 that Health Canada had begun to conduct drug use analysis and that the Department had shown a decline in the number of cases involving access to large amounts of central nervous system drugs. This intervention was stopped in 1999. Health Canada stated in response to our 2000 audit that once consent was obtained, drug utilization review would be fully reinstated. It made similar commitments to the Public Accounts Committee in 2001.

4.47 Health Canada informed us that, by the end of our audit, it had obtained consent from over 174,000 of its clients, about one quarter of all eligible recipients. Nevertheless, it still had not reinstated drug utilization review for these clients. Furthermore, the Department could have conducted retrospective analyses of clients for whom consent had not been provided by replacing names with a code that would have effectively anonymized the data. This would have at least enhanced the Department's capacity to initiate evidence-based program interventions supporting health promotion and education efforts. The Department has not conducted such analyses. In December 2003, it established the Drug Use Evaluation Advisory Committee, with terms of reference finalized in June 2004, in order to develop and recommend a comprehensive program to promote safe, effective, and efficient use of drugs.

"An analysis of the use of anti-platelet therapies in diabetic patients over the age of 55 years, and in particular those using nitrates, demonstrates that there is sub-optimal use of a treatment that can prevent cardiovascular events in individuals at high risk."

Mitchell Levine, MD, MSc, FRCPC
Director, Centre for Evaluation of Medicines
Professor, Department of Clinical Epidemiology
and Biostatistics,
Department of Medicine,
McMaster University

4.48 To examine the potential benefit that retrospective drug utilization review could offer health care professionals, we conducted a series of retrospective anonymized analyses, using departmental databases, in areas where the standard of care is well known.

4.49 Diabetics, for example, have a two- to four-fold greater risk of experiencing a life-threatening cardiovascular event, such as a heart attack, compared with an individual without diabetes. Medical experts indicate that diabetics, particularly those over 30, would derive considerable benefit from being placed on anti-platelet drugs, such as acetylsalicylic acid (ASA) to reduce their risk of heart attack. Medical literature and experts also indicate that diabetics over 55 years of age who have also been diagnosed with heart disease have an even greater risk of heart attack, and thus the need for anti-platelet drugs is increased.

4.50 Our analysis of Health Canada's 2002–03 database identified 14,519 First Nations and Inuit clients who were 55 years or older and being treated for diabetes. More than 7,000 of these clients were not taking anti-platelet drugs. About 2,500 of these diabetics were also on drugs (nitrates) prescribed for heart disease, and over 600 of these clients were not taking an anti-platelet drug. If such information had been identified and subsequently communicated to health care professionals, it may have assisted them in the medical management of at least some clients in this population at risk. Health Canada has since completed a review of priorities for drug use analysis and in fall 2004 plans to communicate with medical and pharmacy professionals about the clinical value of diabetics taking ASA antiplatelet therapy. Such analysis does not require client consent.

4.51 **Attention to seniors is needed.** The need for therapeutic vigilance is vital for seniors if their health care outcomes are to be optimized. The drug benefit programs of Veterans Affairs Canada and Health Canada supported over 166,000 seniors in 2002–03. Many depend on a large number of drugs to maintain their health status and quality of life. However, as the number of concurrent prescriptions taken by a senior increases, so does the potential for adverse drug interactions and reactions. Certain drugs also pose a potential health risk as they are contraindicated for seniors.

4.52 In 2003, the American Medical Association revalidated a list of drugs that were considered to pose a threat to senior citizens. Using a system referred to as Beers Criteria, it assessed the drugs as low- or high-risk for patients 65 years of age and older. We expected organizations with significant numbers of elderly clients to be monitoring the prevalence of these drugs being dispensed to their senior clientele.

4.53 We limited our analysis to the prevalence of high-risk drug use within this age group in the programs of Veterans Affairs Canada and Health Canada. In 2002–03, the two departments collectively had 19,700 senior clients who were dispensed one or more such drugs. Furthermore, we found that 8,945 seniors had been prescribed two or more high-risk drugs concurrently. As shown in Exhibit 4.6, 109 seniors were taking two or more high-risk drugs concurrently that were prescribed by four or more doctors and dispensed by four or more pharmacies. Of these, 44 seniors were taking four or more high-risk drugs.

Exhibit 4.6 Seniors receiving two or more high-risk drugs*

	Number of pharmacies				
Number of doctors	**1**	**2**	**3**	**4 or more**	**Total**
1	4,675	338	17	4	5,034
2	1,847	735	84	7	2,673
3	361	252	77	11	701
4 or more	180	147	101	109	537
Total	7,063	1,472	279	131	8,945

*Drugs classified as high-risk using the Beers Criteria

4.54 To mitigate the potential risk to patients, doctors need to know the entire drug use profile of a patient, particularly if it involves multiple high-risk drugs. As this is not always possible, multiple high-risk drugs prescribed by multiple doctors and dispensed by multiple pharmacies that may not have their databases linked have potentially serious implications for elderly patients. Neither of the departments' systems produces alerts for these drugs.

4.55 We also looked at the number of different drugs that senior clients of Veterans Affairs Canada and Health Canada had been prescribed for

"The common use of potentially inappropriate drugs should serve as a reminder to monitor their [patients'] drug use closely. Pharmaceutical claims databases can be important tools for accomplishing this task . . ."

Archives of Internal Medicine 2004; 164:1621-1625

concurrent use in 2002–03. The medical literature indicates that the risk of serious adverse drug reactions in patients over the age of 65 increases along with the number of concurrent medications. Some experts consider that when the number of drugs exceeds seven, the risk of serious drug reactions approaches 100 percent. Even so, many senior citizens need to take multiple drugs simultaneously as the benefit of these medications exceeds their potential risk. However, experts suggest that these patients should be assessed by doctors regularly for adverse drug interactions and reactions. Thus, access to information contained in the claims processing databases becomes vital.

4.56 In 2002–03, almost 4,000 senior clients of Veterans Affairs Canada and Health Canada were prescribed 10 or more drugs simultaneously for 3 to 12 months (1,975 seniors over 80 years of age were on 10 or more drugs.) We selected a representative sample of 332 individuals from this population and had their drug use profiles assessed through a computer-based model for potentially harmful drug interactions. The assessment identified 1,278 potential problems of varying levels of severity. According to the assessment, 60 percent of these clients had drug use profiles that normally should be avoided but may be necessary depending on individual clinical circumstances; 28 percent of clients had drug use profiles that needed adjustment in order to avoid potential problems.

"Patients who receive multiple medications concurrently are at increased risk for drug interactions and adverse effects."

Mitchell Levine, MD, MSc, FRCPC
Department of Medicine, McMaster University

4.57 The results of this assessment were subsequently reviewed by independent medical experts. Although many of these drug interactions were considered minor in nature or difficult to assess given the lack of clinical information, some were considered sufficiently serious to warrant medical review. In many provinces, comprehensive drug use information is not always available to the doctor or pharmacist. Pharmacy databases are not always interconnected and thus the complete drug use profile of an individual needing a new prescription may not be available. The federal claims processing databases constitute the only comprehensive source of data on drug use for many clients, but this information is rarely made available to health care decision makers.

4.58 **Recommendation.** As a minimum, Veterans Affairs Canada, Health Canada, National Defence, and the RCMP should upgrade their existing claims processing systems, as necessary, to ensure that each system

- monitors pharmacists' overrides of warning messages for drug use,
- includes an alert notification when clients access large numbers of prescription drugs, and
- includes an alert notification for potential misuse of narcotics and benzodiazepines.

Organizations' response. Health Canada, Veterans Affairs, National Defence, and the RCMP agree with this recommendation. Work is underway to implement these changes, where required. Implementation may be limited by third-party point-of-sale software as well as security and privacy issues. In the longer term, the accelerated development of electronic health records and electronic prescribing practices, as per the National Pharmaceutical

Strategy commitments of First Ministers, will provide additional tools to address the specific concerns of the Auditor General.

4.59 **Recommendation.** Veterans Affairs Canada, Health Canada, National Defence, and the RCMP should begin to systematically analyze their claims processing databases for high-risk patterns of drug use, including those of narcotics and benzodiazepines. This is particularly important for high-risk groups such as senior citizens. These organizations should seek to use these analyses for

- communicating drug use information, as appropriate, to health care providers; and
- providing client-specific, retrospective information on drug use to pharmacists and doctors to assist them in achieving the best possible health care outcomes, while ensuring that client privacy is appropriately respected.

Organizations' response. Agreed. Most federal organizations have been involved in drug utilization evaluation to various degrees prior to this report and have successfully used it to identify areas of concern. The organizations will conduct more systematic analyses and co-ordinate efforts to identify high-risk patterns of drug use and communicate this information to health care professionals as appropriate. Privacy and security are significant issues that will need to be addressed. When implemented, electronic health records and electronic prescribing practices, as per the National Pharmaceutical Strategy commitments of First Ministers, will provide further tools to identify high-risk patterns of drug use and communicate information to health care professionals.

Controlling costs and managing the programs

4.60 The cost of providing drug benefits is influenced by a number of factors—some clearly not within the organizations' control, such as growth in the size of eligible populations; aging clientele; and the introduction of new, more costly drugs into the marketplace. However, organizations can influence some factors that have a significant impact on costs, and these factors must be managed. We looked at how organizations were managing several critical factors, including the following:

- **Drug products that federal organizations choose to cover.** Determining which drug products are put on a formulary and their benefit status are key determinants of program costs. Each formulary constitutes the basis for all drug payments made by an organization.
- **The use of strategies for containing costs.** Some drugs that provide the same therapeutic benefit vary significantly in price. A number of options to contain prices are available to federal programs to minimize costs without jeopardizing the quality of care provided to clients.
- **Appropriate controls for contractor systems.** Five of the six federal organizations deliver their programs through claims processing systems run by contractors. Ensuring that contractors have adequate controls in place to verify the eligibility of clients and that only appropriate, approved benefits are paid is important to avoid unapproved costs to the program.

Formulary—A specified list of drugs authorized for use within each drug program and, in some cases, specifying the drug benefit status.

Benefit status—The designation assigned to prescription drugs: that is, full benefit, limited benefit, or no benefit. Full-benefit drugs are automatically approved when prescribed, limited-benefit drugs are approved only under certain criteria, and no-benefit drugs are generally not approved.

- **Appropriate controls for pharmacy payments**. Pharmacies are the recipients of much of the federal spending on these programs. Ensuring that pharmacists follow appropriate practices for billing federal programs is key to managing costs.

Drug benefit approvals differ by program

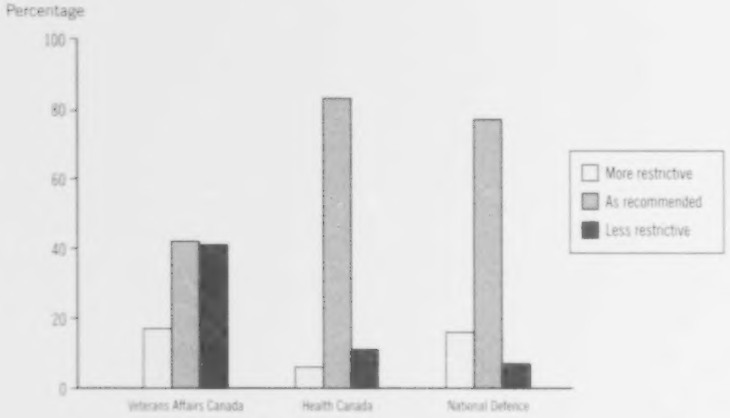
4.61 Each federal organization manages its own drug benefit formulary. For Veterans Affairs Canada, Health Canada, National Defence, and the RCMP, this includes both prescription and over-the-counter drugs. Citizenship and Immigration Canada has its own formulary and does not include many over-the-counter products. Correctional Service Canada operates five separate formularies, one for each of its operational regions.

4.62 **Federal committee for assessing new drugs has limited influence.** One of the key challenges for all of these organizations is determining which drugs to include on their formularies; each organization has autonomy in this complex process. In 1999, the federal government established the Federal Pharmaceutical and Therapeutics (P&T) Committee to provide all organizations with evidence-based advice on new drugs being considered for inclusion on federal drug formularies. The intent was to avoid duplication of effort and assure a consistent and equitable approach to providing drug benefits. Since its inception, this committee has assessed over 200 drugs newly introduced to the Canadian market. It has advised federal drug benefit programs on the relative therapeutic merits of new drugs and recommended the benefit status based on clinical evidence. In March 2002, the Common Drug Review Directorate of the Canadian Coordinating Office of Health Technology Assessment was established, and in September 2003 it became responsible for assessing new chemical entities and new combination drug products.

4.63 We expected that organizations' decisions on the benefit status of new drugs would closely mirror the recommendations of the P&T Committee. The benefit status determines which drugs are included on organizations' formularies and how easily they are obtained. Therefore, we expected that organizations would have similar formularies, at least for those drugs approved since 1999.

4.64 To assess how organizations followed the advice of the P&T Committee, we examined the over 200 drugs it had reviewed. Health Canada, National Defence, and Veterans Affairs Canada were active members of the P&T Committee, and thus we expected consistency between these programs. We found that Health Canada and National Defence had accepted the majority of the committee's recommendations and had not augmented their formularies with drugs not considered by the committee. Veterans Affairs Canada, however, listed 41 percent of the drugs reviewed by the committee in a less restrictive fashion than recommended (Exhibit 4.7). From 1999 to 2003, the Department also added at least 18 new drugs to its formulary that the Committee had not reviewed.

Exhibit 4.7 Consistency with recommendations made by the Federal Pharmaceutical and Therapeutics Committee



4.65 Although Correctional Service Canada, Citizenship and Immigration Canada, and the RCMP were founding members of the committee, they were not active participants in the committee's assessment process. Citizenship and Immigration Canada's formulary includes just over half of the drugs recommended by the P&T Committee as full-benefit drugs since 1999; the remainder of the drugs are made available by exception only.

4.66 **Provision of drug benefits is inconsistent.** We found that Health Canada relied on the evidence-based advice of the P&T Committee and therefore did not have its own formulary review committee. In contrast, Veterans Affairs Canada, National Defence, and Correctional Service Canada had their own formulary review committees, each comprised of program managers and advisors with varying levels of medical expertise. These committees routinely assessed the advice of the P&T Committee against broader departmental considerations; in many cases, their conclusions varied among each other and with the recommendations of the P&T Committee, without clear explanations. For example, Veterans Affairs Canada put a specific drug on its formulary as a full-benefit drug that the P&T Committee had recommended not to include. Health Canada included the same drug as a limited-benefit drug. National Defence followed the committee's advice and decided not to put it on its formulary. Citizenship and Immigration Canada also did not include the drug on its formulary, although it neither participated in the P&T Committee nor had its own formulary review committee.

4.67 It is not clear why the designation of drugs differs from one program to another. Although the prevalence of certain diseases varies among client populations, the therapeutic requirements should be the same.

Strategies for containing costs are underused

4.68 The federal government spent $438 million on drug products in 2002–03. We expected organizations to use various means of minimizing the prices they pay for drugs, including well-established cost management strategies such as large-volume purchasing, maximum allowable cost pricing, lowest-cost alternative, and reference-based pricing (Exhibit 4.8). The strategies are not mutually exclusive; many provinces use various combinations of these strategies. To assess organizations' efforts to contain costs, we conducted a number of tests and analyses using data from their drug claims databases where available. We also reviewed relevant literature, consulted experts, and reviewed some cost containment practices of other large drug benefit programs in Canada and abroad.

Exhibit 4.8 Some cost management strategies

There are a number of common strategies that organizations could use to control costs. These include the following:

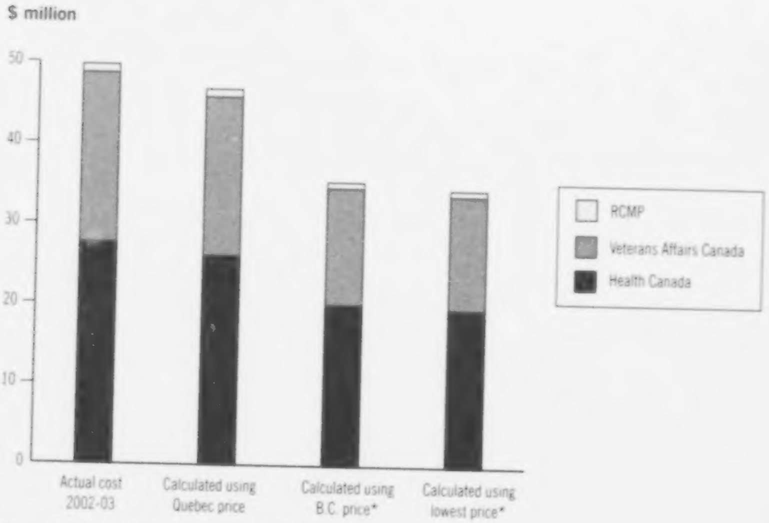
- **Large-volume purchasing**—A common procurement strategy whereby unit costs drop as purchase volume increases.
- **Maximum allowable cost pricing**—A cost-saving strategy whereby the maximum allowable unit price is negotiated.
- **Lowest-cost alternative**—The least expensive of several drugs that are all chemically identical. Pharmacists are to follow provincial and territorial pharmacy legislation and policies to identify interchangeable products and to select the lowest-priced brand.
- **Reference-based pricing**—The process whereby, in a class of drugs of similar therapeutic efficacy, normally only the cost of the least expensive drug is reimbursed. If more expensive drugs in the class are used and not approved through a medical exceptions process, the reimbursement limit is the cost of the least expensive drug, with the patient paying the difference.

4.69 **Most federal organizations do not consistently use large-volume purchasing.** Large-scale purchasers commonly seek price reductions for large-volume purchases. We found that National Defence took advantage of negotiated drug prices for most of its purchases. Ninety percent of its drugs are dispensed on its bases. For on-base operations, the Department obtained the 500 drugs it most commonly used (and many others) at negotiated, volume-adjusted prices, and had them delivered through a wholesale distributor on a "just-in-time" basis. This amounted to significant discounts over normal wholesale prices. Correctional Service Canada also kept unit prices low by tendering, acquiring drugs through standing offers, and having its institutions classified as hospitals and pharmacies in some provinces.

4.70 The amounts paid for the same drug products vary among federal and provincial jurisdictions in Canada and even among the different federal programs. Citizenship and Immigration Canada often reimburses pharmacies at rates that reflect those of the respective provincial governments, often paying different drug prices for each province. If all federal drug benefit programs consistently paid only the lowest amounts paid for drugs by federal and provincial programs, we believe substantial savings would be realized.

4.71 For illustration purposes, we compared the amounts paid by Veterans Affairs Canada, Health Canada, and the RCMP for the top 20 drugs used in Canada with the unit prices paid by the British Columbia and Quebec governments (Exhibit 4.9). In 2002–03 the three federal programs spent $49.7 million on these drugs (excluding dispensing fees, mark-ups, provincial co-payments, and other costs). Had their programs paid only the unit prices of the B.C. or Quebec governments, where advantageous, these programs would have saved $4 million. Had these calculations included B.C.'s reference-based prices, as discussed in paragraphs 4.75 to 4.79, the potential savings would have exceeded $15 million. These potential savings are illustrative only, as these prices have not been negotiated at a national level. However, they point to savings that may be possible through a centralized process of negotiating national drug prices. Such a strategy is consistent with recommendation 37 of the *Commission on the Future of Health Care in Canada* (R. J. Romanow, Final Report, 2002) for establishing a national drug agency that "would be responsible for leading negotiations with pharmaceutical companies and handling bulk purchase agreements in an effort to ensure that the price of prescription drugs can be contained."

Exhibit 4.9 Top 20 drugs used in Canada—Comparison of actual federal cost versus potential cost using provincial prices



*Includes British Columbia reference-based price where appropriate

4.72 In its *Final Report on the State of the Health Care System in Canada* (October 2002), the Standing Senate Committee on Social Affairs, Science and Technology also appreciated "the substantial buying power of a single national buying agency which would strengthen the ability of public prescription drug insurance plans to negotiate the lowest possible purchase prices from drug companies." We also believe a process of centralized negotiation would offer significant opportunities for cost savings, well beyond what individual programs could achieve.

4.73 **Lowest-cost alternative strategy underused.** A lowest-cost alternative strategy would systematically remove drugs from a benefit list or restrict their use, as less expensive and equally effective alternatives become available. In this regard, some provinces and territories have already taken steps to implement policies requiring substitution of drugs with a lowest-cost alternative. These policies encourage pharmacists to substitute a therapeutically equivalent generic drug for a higher-cost brand name drug unless the latter is medically justified. If a client insists on the higher-cost drug and it is not justified, the claim is reduced to the lowest-cost alternative and the client must pay the difference.

4.74 The introduction to Health Canada's drug benefit list states that the program will reimburse only the best price for drug products in a group of interchangeable products. Pharmacists are to follow provincial and territorial pharmacy legislation and policies to identify interchangeable products and to select the lowest-priced brand. We therefore expected Health Canada and possibly other federal organizations to be reimbursing only the lowest-cost interchangeable drug products. We found that National Defence restricts the options available for many therapeutically equivalent drug products, both to contain costs and to limit the number of drugs it must deploy to operational settings. Citizenship and Immigration Canada also uses this lowest-cost alternative approach, replacing brand name drugs with generic equivalents as they become available. As such, its drug benefit list is well under half the size of the lists of Veterans Affairs Canada and the RCMP.

4.75 **Reference-based pricing not fully used.** British Columbia selectively uses reference-based pricing as another strategy to control costs. Drugs in the same class are not chemically identical but they are equivalent, as recommended by an expert advisory committee. If more expensive drugs in a class are used and not approved through a medical exceptions process, the reimbursement limit is the cost of the least expensive drug, with the patient paying the difference. Large drug benefit programs can use referenced-based pricing as a means of minimizing drug costs without compromising the quality of care.

4.76 **Test case: Drugs used to treat disorders such as stomach ulcers**. We explored the merit of reference-based pricing by examining organizations' purchases of proton pump inhibitors (PPI), a class of drugs used to treat certain disorders such as stomach ulcers. National Defence and the Province of British Columbia consider that although individual proton pump inhibitors are different chemical entities, their therapeutic effects are sufficiently similar to make them fully equivalent. In accordance with recommendations by both organizations' expert advisor committees on the drugs' therapeutic equivalence, cost determined which of the interchangeable drug products were listed on their respective drug formularies.

4.77 The cost of some proton pump inhibitors is over $2.00 per dose. In March 2001, National Defence amended its coverage for proton pump inhibitors to include only one for first-line coverage, which it obtained for $0.45 per dose. In June 2003, British Columbia amended its Pharmacare coverage for proton pump inhibitors so that first-line coverage would be paid only for the least expensive PPI product, which it obtained for $0.6955 per dose. In October 2003, Health Canada also began to take a similar approach, requiring the lowest-cost product to be used unless a more expensive drug was medically justified. At the end of our audit, Health Canada had not yet conducted an analysis to determine the extent of savings.

4.78 Federal drug programs collectively paid over $17 million for PPIs in 2002–03. To estimate the potential savings that organizations could have realized, we applied both British Columbia's and National Defence's price for the lowest-cost alternative PPI to each federal program's actual purchases for 2002–03. We found that Veterans Affairs Canada, the RCMP, and Health Canada could have collectively saved between $11 million (British Columbia pricing) and $13 million (National Defence pricing) in PPI costs in one year by requiring that their formularies cover only the lowest-cost PPI, unless medically justified (Exhibit 4.10). While these estimates are illustrative only, we believe that reference-based pricing could have offered significant savings without compromising patient care; higher-priced alternatives would have been made available if medically justified.

4.79 Although the quality of care is important, meeting the therapeutic needs of clients and achieving a cost-effective program need not be mutually exclusive. The examples of large-volume purchasing and reference-based pricing illustrate the potential for significant savings without compromising health care. We believe these do not represent the full extent of the potential for such savings. Similar opportunities have also been identified that relate to the growing use of new drugs for important treatment areas, such as for arthritis; there may be many more.

Most organizations have appropriate controls for claims processing systems

4.80 Five of the six federal programs we examined have centralized claims processing databases on drug use that are operated by claims administrators. This arrangement facilitates the processing of millions of drug claims from about 7,400 pharmacies each year. During 2003–04, claims administrators were paid $43.3 million for administrative services, including $13.2 million in transaction fees for drug claims. With hundreds of millions of dollars paid out for millions of transactions each year, we expected that organizations would have a control framework to ensure that contractors administer claims efficiently and effectively.

4.81 **Controls for claims verification are sufficient.** We examined control frameworks in each of the five organizations that use contractors as claim administrators. We expected these organizations to be able to ensure that their contractors have controls in place to verify eligibility, that drugs are matched with the drug benefit list for appropriateness and cost, and that procedures are followed for drugs requiring prior approval and special

Exhibit 4.10 Cost containment strategies—Proton pump inhibitors (PPI)*, 2002–03 ($ thousands)

Organization	Actual cost of PPI	Cost using National Defence price ($0.45)	Cost using British Columbia's Pharmacare price ($0.6955)	Range of possible savings
Health Canada	10,802	2,149	3,322	7,480 to 8,653
Veterans Affairs Canada	6,233	2,135	3,144	3,089 to 4,098
RCMP	470	100	154	316 to 370
Total	**$17,505**	**$4,384**	**$6,620**	**$10,885 to $13,121**

*Price comparisons for different drugs within the same class

authorization. We also expected these organizations to flag duplicate claims and ineligible drugs, and to verify the validity, completeness, and accuracy of claims submitted.

4.82 We reviewed samples of system reports designed to alert the organizations to ineligible recipients, mismatched benefits, and unapproved costs. We expected the organizations to carry out a regular review of these reports, of suspended and rejected claims, and of any anomalies.

4.83 We found that the five organizations have adequate controls in place for pre-payment verification—a process that confirms the eligibility of the client and the validity of the drug benefit before payment is approved. The organizations are able to ensure that procedures for prior approval and special authorization are followed. We also found that all of the organizations using contractors to process claims review post-payment transaction data to check accuracy and identify anomalies. We did not audit individual transactions or the claims payment systems owned and operated by the contractors.

4.84 **Veterans Affairs Canada delegates key program components.** In our examination of program delivery, we found that Veterans Affairs Canada had delegated a number of important functions to its claims administrator, including the following:

- participating and providing secretariat services for the Department's Formulary Review Committee and providing key technical advice and recommendations on proposed benefit status and on additions and deletions of drugs on the benefit list;
- playing a leading role in a departmental committee that met in 2002–03 to identify cost-saving proposals for the drug purchases;
- dealing, on behalf of the Department, with pharmacies and pharmacy associations in Atlantic Canada for dispensing fees and other matters;
- developing the plans for pharmacy audits (for departmental approval);

- serving as the primary departmental contact for industry when companies seek information on the Department's drug benefits program; and
- leading much of the Department's analysis of drug use. The contractor is also specifically referenced in Veteran Affairs Canada's Drug Utilization Review policy manual.

4.85 We are concerned about the extent to which the contractor is involved in so many important aspects of Veterans Affairs Canada's program activities. We saw no evidence that the contractor makes management decisions on behalf of the Department. Nonetheless, this delegation of program responsibilities creates significant dependence by Veterans Affairs Canada on its contractor for making informed decisions about key elements of its drug benefit program. This includes, for example, analyzing whether appropriate health care is being received by its members. We are also concerned that key technical capabilities and analytical competencies have been delegated away from the Department, which may compromise its ability to make important decisions independent of the contractor. The RCMP also relies on Veterans Affairs Canada's claims processor for drug use reports and industry representation. In contrast, National Defence has retained these functions within its organization. Health Canada and Citizenship and Immigration Canada have separate claims processors and do not rely on them to make decisions on program management.

Improved controls for pharmacy payments are needed

4.86 For most of the programs we audited, pharmacies are key partners in the delivery of prescription drug benefits to government clients. Most of Canada's pharmacies process drug claims for federal programs. Given the sheer volume of transactions and funds involved, we expected organizations to have processes in place to monitor and minimize pharmacy costs.

4.87 To assess the impact of pharmacy costs on organizations' overall drug costs and to assess opportunities for savings, we examined the fees paid to pharmacists by Health Canada's and Veterans Affairs Canada's programs. We found that in most cases each department has its own dispensing fee and mark-up schedules. Furthermore, we found that dispensing fees paid by federal programs are often higher than those paid by provincial drug benefit programs.

4.88 The Health Care Coordinating Initiative (HCCI), now the Federal Health Care Partnership, was established in 1994 to "co-ordinate federal government purchasing of health care services and products for their eligible clients at the lowest possible cost through co-ordination of effort among departments and agencies." In 1997 the HCCI negotiated a single dispensing fee schedule with the Saskatchewan Pharmacy Association on behalf of Health Canada, Veterans Affairs Canada, and the RCMP. This agreement was renewed in July 2000 for three years. The HCCI estimated the savings for these three programs at about $2 million per year and has forecast that these savings will continue through 2006–07.

4.89 In 2002–03, the federal drug benefit programs paid close to $100 million in dispensing fees and mark-ups to pharmacies, more than 20 percent of federal expenditures on drug benefits. Given the significant savings negotiated with pharmacists in Saskatchewan, we expected that similar negotiations would have occurred with other provincial pharmacy associations. This has not been the case. Participation in the Federal Health Care Partnership by federal organizations is voluntary, and the Partnership represents the federal government only when organizations choose to participate.

4.90 **Lack of management control in payment of dispensing fees.** We analyzed dispensing fee data for evidence of a practice referred to as prescription splitting. Generally, the length of time covered by a prescription is determined by the doctor. Medications for many chronic illnesses are normally prescribed for periods of one to three months. As such, we expected organizations to review and challenge pharmacists' dispensing fee charges for drugs associated with chronic illnesses and dispensed for shorter periods.

4.91 We analyzed the claims processing databases of Health Canada and Veterans Affairs Canada to identify clients who had received the same drug continuously for at least three months; this would normally reflect the use of the drug for an ongoing medical condition. For this group of clients, we found that many individuals on long-term medications were routinely being issued weekly and even daily prescriptions. Many clients were being dispensed six or seven different drugs daily, with full dispensing fees being charged to the program each day, for each drug. In one case, a client was dispensed 12 drugs on an almost daily basis. Professional fees were submitted each day for each drug, totalling $21,000 in 2002–03 for that client alone.

4.92 We recognize that short-term supervision may be necessary in some cases. Drugs such as methadone or those for dementia, other cognitive difficulties, or for clients in a nursing home may be exceptions; however, the requirement for full dispensing fees for each client for each prescription results in increased costs. We estimated that the programs of Veterans Affairs Canada and Health Canada paid dispensing fees for about one million transactions beyond services provided once a month for the same long-term drug; a third of these fees were for services provided more than once a week (average of close to five prescriptions per month for the same drug to the same client). With dispensing fees ranging from $6.54 to $9.53, we believe that federal organizations need to closely monitor pharmacists' practices for charging dispensing fees.

4.93 **Processing non-prescription products is expensive.** Some federal drug benefit programs pay for non-prescription products, such as acetaminophen, ASA, certain shampoos, and cold medicines. Typically, to receive federal payment for these products, the client has to visit a doctor, obtain a prescription, and then have a pharmacist provide the product and record the delivery of the benefit. In our 1996 audit of Veterans Affairs Canada's Health Care Program, we recommended that the Department explore less costly means of providing over-the-counter (OTC) medication to its clients. The Department has done this but has not implemented a process to achieve significant cost savings.

4.94 In 2002–03, the drug benefit programs of Health Canada, Veterans Affairs Canada, the RCMP, and National Defence paid over $48 million in claims for over-the-counter drugs (Exhibit 4.11). About 40 percent of this cost was for dispensing fees or mark-ups. Provinces pay for consultations with doctors and any associated medical assessments while the federal government covers the cost of the product and the pharmacy dispensing fee. As currently structured, the process can be very costly to both the provincial and federal health care systems. For example, providing a client with a common OTC medication, such as a $7 bottle of vitamin C, could cost the federal and provincial governments more than $20.

Exhibit 4.11 Over-the-counter drug expenditures, 2002–03 ($ thousands)

Organization	Expenditures
Health Canada	40,885
Veterans Affairs Canada	5,577
National Defence	1,381
RCMP	245
Total	**$48,088**

4.95 Some organizations have made efforts to reduce costs. For those Canadian Forces members unable to access a base pharmacy for over-the-counter drug products, National Defence provides them with a special card that lists the OTC drugs the program will cover. A prescription is not required. Instead, qualified pharmacists document the OTC drug transaction and are reimbursed for the cost of the drug plus any necessary consultation costs. For National Defence, this consultation cost is similar to a dispensing fee but the doctor's fee is avoided. In some provinces and territories, Health Canada has established dispensing fees for over-the-counter drugs that are lower than the fees charged for dispensing prescription drugs. Citizenship and Immigration Canada and Correctional Service Canada do not provide appreciable over-the-counter benefits to their clients.

4.96 **Better strategies are needed for pharmacy audits.** The timely, strategic, and effective audit of pharmacies is an important tool, both to recover funds and to deter potential abuse. We expected that organizations would have a systematic and comprehensive audit strategy based on an assessment of risk aimed at identifying irregularities, errors, and fraudulent claims that are the most frequent and have the largest dollar-value billing.

4.97 Four of the organizations we examined (Health Canada, Veterans Affairs Canada, National Defence, and the RCMP) audit pharmacies through their service providers. Citizenship and Immigration Canada and Correctional Service Canada do not conduct pharmacy audits.

4.98 Health Canada has a robust audit program. It identifies pharmacies for audit through pharmacy profiling. This is a procedure that systematically reviews the claims history of each pharmacy through a series of weighted tests, based on risk and designed to assess inappropriate billing patterns. Every pharmacy is assessed in each reporting period and assigned a rank based on a composite test score reflecting a sophisticated risk-profiling process. The Profiling Review Committee at Health Canada makes the final selection of pharmacies for audit based on the composite test scores and all of the various assessments and reviews. The Department's contractor carries out the audits on its behalf.

4.99 In our 2000 follow-up chapter, First Nations Health, we recommended that Health Canada enforce the contract requirements for the audit of pharmacies. In our most recent audit, we found that the Department had substantially increased the number of audits of pharmacies. While it completed only 84 pharmacy audits during the three years ending March 2001, it completed 265 pharmacy audits during the subsequent three years ending March 2004.

4.100 We also found that the risk-profiling process appears to target appropriate pharmacies for audit. Of pharmacies that dispensed more than 15 prescriptions per client for the same drug in 2002–03, the top 10 pharmacies billed over $1.1 million for services to these clients. Each of these pharmacies has been subject to at least one on-site audit since April 2002.

4.101 Veterans Affairs Canada, National Defence, and the RCMP rely on the contractor to recommend pharmacies for audit based on their own profiling exercise and an analysis of trends of the previous reporting period. Management of Veterans Affairs Canada reviews recommendations of pharmacies to audit and can adjust the proposed audit plan. Health Canada's rigorous techniques for selecting pharmacies to audit are not replicated in any of these other organizations' programs. Furthermore, since all federal organizations use the same retail pharmacies across Canada for at least some of their clients, opportunities for joint audits and sharing of audit results are being missed.

4.102 **Amounts owing the Crown are not always collected.** Pharmacy audits do not always lead to recovery of overpayments identified. From April 1998 to March 2004, the claims administrator for Health Canada completed 349 pharmacy audits. These audits led to recovery of $1.7 million, but an additional $2.1 million has yet to be recovered. From 1999 to 2003, the claims administrator for Veterans Affairs Canada conducted 439 pharmacy audits. These audits led to recovery of $1.1 million, but an additional $700,000 is pending recovery.

4.103 National Defence administers most of its drug claims through base pharmacies and relies on Veterans Affairs Canada's claims administrator to identify and conduct audits of off-base pharmacies. The RCMP relies on the claims administrator to identify and conduct audits as it sees fit.

4.104 Once audits have been completed and amounts to be recovered have been determined, pharmacies may not have sufficient incentive to repay the amounts owing. The consequence of improper billing by a pharmacy is that the pharmacy must pay back the amount agreed as overcharged, with repayment terms arranged. While a pharmacy can be suspended from being a provider, Health Canada and Veterans Affairs Canada expressed concern that doing so may compromise the delivery of services to clients, particularly those in rural areas. These departments have not recorded the outstanding amounts owed by pharmacies in the Public Accounts as required by the Treasury Board Policy on Receivables Management.

4.105 Overall, federal organizations are currently not very effective in controlling costs. Despite the existence of advisory and co-ordinating mechanisms such as the Federal Pharmaceutical and Therapeutics Committee and the Federal Health Care Partnership, decisions on the provision of drug benefits are made with little attempt to reconcile differences between organizations. While we noted some efforts to contain costs, federal organizations were not systematically pursuing well-established strategies being used elsewhere.

4.106 **Recommendation.** The federal government should establish an arrangement, characterized by a centrally-managed process, which will permit it to

- develop and manage a core formulary common to all federal drug benefit programs,
- develop a common evidence-based process to ensure that all departmental exceptions to the core formulary will be made with appropriate transparency and accountability,
- obtain the best value for each drug product listed on the core formulary,
- establish a single federal schedule for dispensing fees,
- explore less costly means of processing over-the-counter benefits, and
- develop a common risk-profiling and auditing process for all pharmacy audits.

Government's response. Federal organizations agree to work together to explore cost-effective drug use and system efficiency as per this recommendation. In the longer term, as part of federal involvement in the development and implementation of the National Pharmaceutical Strategy, the federal government will ensure that the specific needs of federal client populations are reflected.

4.107 **Recommendation.** Health Canada and Veterans Affairs Canada should identify the amounts owing to the Crown resulting from pharmacy audits in the Public Accounts. In accordance with Treasury Board policy, Health Canada and Veterans Affairs Canada should institute procedures to expeditiously recover these amounts owing (including interest).

Departments' response. Agreed. Health Canada and Veterans Affairs Canada will identify amounts owing as a result of pharmacy audits, in the Public Accounts effective 2005-06.

Effective practices of federal organizations

4.108 The federal organizations we audited are managing parts of their programs very well. Because of the similarities in the programs, many of the better practices in one program could be applied to the others. A few of the most notable practices include the following:

- The Federal Pharmaceutical and Therapeutics Committee and the Federal Health Care Partnership seek to enhance the management of the provision of drug benefits for all federal organizations.
- Health Canada and National Defence adhere closely to the Federal Pharmaceutical and Therapeutics Committee.
- The National Defence Formulary Review Committee, comprised of medical specialists and postgraduate clinical pharmacists, has enhanced the Department's formulary to meet operational needs. These same experts are routinely used to address requests for limited-use benefit drugs, thereby ensuring sound, evidence-based decisions.
- National Defence, Correctional Service Canada, and Citizenship and Immigration Canada purchase drugs using competitive, low-cost acquisition practices. Citizenship and Immigration Canada eliminates brand name products from its formulary as generic equivalents become available.
- Veterans Affairs Canada, Health Canada, the RCMP, and National Defence use claims processing systems with the capability of performing multiple checks and efficient processing of tens of thousands of transactions at a time. While our audit points to the need to enhance the point-of-service support provided to pharmacies, the basic capacity is already in place.
- Veterans Affairs Canada, National Defence, and the RCMP have teamed up to use a common claims processing administrator.
- Health Canada has established a reduced dispensing fee for over-the-counter drug products for some provinces and territories, which could lead to significant savings if applied nationally to all programs that supply these products.
- Health Canada uses comprehensive risk-profiling techniques to identify pharmacies for audits.
- Veterans Affairs Canada conducts patient-based drug utilization review, targeting high-risk clients; though not comprehensive, the system is oriented to health and safety.

4.109 If all federal drug benefit programs used some of the practices listed above, and other favourable practices identified elsewhere in this chapter, we believe that the benefit from such opportunities would be significant, without negatively affecting health outcomes or compromising operational activities.

Timely and effective analysis of drug use trends could also lead to positive health outcomes for clients.

Conclusion

4.110 In this audit we examined how the federal government ensures that its clients receive appropriate drug benefits and how the federal government manages its costs.

4.111 Although all federal drug benefit programs have a mandate, most organizations have not established clear objectives and performance measures for their drug benefit activities. As a result, they lack the necessary information for reporting to Parliament on the performance of their drug benefit programs.

4.112 Organizations do not use the substantial information on drug use in their databases to analyze and encourage appropriate practices. Our audit found several important patterns of drug use that organizations had not identified. It also found that Health Canada had not conducted drug use analysis it had committed to do in previous audits and to the Public Accounts Committee.

4.113 Federal organizations are not taking sufficient measures to contain costs. Organizations' management of their drug formularies is inconsistent and they are not doing enough to minimize the costs of drugs they provide. We believe that numerous opportunities for significant savings could be more fully realized if actively pursued.

4.114 Organizations have made notable progress on some recommendations from our past audits. We believe that increased sharing of best practices among the organizations would help to correct deficiencies that still exist in their drug benefit programs and result in substantial cost savings.

4.115 We also believe that prompt attention to the many issues raised in this audit is in the interest of taxpayers and, most important, in the interest of the approximate one million clients who depend on these programs.

Overall government response. The organizations agree with all of the recommendations. The recommendations support and build on the commitments of the First Ministers to develop and implement a National Pharmaceutical Strategy to address concerns faced by all jurisdictions. The Strategy provides the foundation for new approaches to promote cost-effective drug use and system efficiency, to the advantage of clients and taxpayers. The organizations are committed to ongoing collaboration in the development and implementation of the Strategy. Decisions on the specifics and timing of the responses are underway and will be communicated to the Office of the Auditor General within a few months.

About the Audit

Objectives

The Canadian Council of Legislative Auditors (CCOLA) developed the first six objectives and corresponding criteria for this audit as a means of standardizing the approach taken by the federal government and provinces in planned concurrent audits of respective drug benefit programs. In addition to addressing these objectives, we followed up on previous audits in this area and assessed best practices.

The objectives of our audit included the following:

- to assess whether the organization has adequate procedures in place to measure the performance of the drug/pharmacare program;
- to assess whether the organization monitors the quality and relevance of drug use and encourages appropriate and economical practices;
- to assess whether the organization has adequate procedures in place to ensure that resources are managed with due regard for cost-effectiveness;
- to assess whether the organization has adequate procedures in place to ensure the eligibility of the insured persons and appropriate collection of premiums and other fees;
- to assess whether the organization has adequate procedures in place to ensure compliance with legislation and whether its policies and procedures for approving, processing, and paying claims are adequate and are being followed;
- to assess whether there is adequate reporting on the drug/pharmacare program's performance and whether reports to Parliament/legislature are presented in the prescribed timeframe;
- to assess whether organizations have taken satisfactory action on deficiencies identified in previous audits; and
- to assess the extent to which federal drug benefit programs have incorporated best practices from other federal programs, from provincial government programs, and from private sector and international programs.

Scope and approach

The focus of this audit was all federally sponsored drug benefit programs. We examined programs in Citizenship and Immigration Canada, Correctional Service Canada, Health Canada, National Defence, the Royal Canadian Mounted Police, and Veterans Affairs Canada.

We examined the mandates of the organizations and the various programs' eligibility rules. We also examined the management controls for claim payments in each program. This included a review of the contracts between the organizations and the claims processors. We analyzed the organizations' formularies as well as the mandate and proceedings of the Federal Pharmaceutical and Therapeutics Committee. We also analyzed the organizations' drug use and transaction databases. Where relevant, we relied on audits conducted by other organizations. We did not audit individual drug benefit transactions.

We examined the action taken by Health Canada in response to our 2000 recommendations as well as the action taken by Veterans Affairs Canada in response to our 1996 recommendations on non-insured health benefits. We interviewed departmental staff involved in the non-insured health benefits programs. We reviewed documentation, including legislation, regulations, program documents, and studies, and we reviewed all information collected for best practices. To conduct our data analysis, we obtained anonymized data of all organizations' programs, where available, from 2002–03 and available data for 2003–04.

To complete our analyses of seniors receiving 10 or more drugs simultaneously (paragraph 4.56), we selected simple samples from four separate populations. The sample sizes were sufficiently large to render confidence intervals of plus or minus 10 percent, at a 95 percent or higher level of confidence for each population. Predictions of the combined populations were calculated using weighted averages. The confidence intervals of these predictions were no larger than plus or minus 5 percent, at a 95 percent level of confidence.

To complete our analysis of federal and provincial price comparisons (paragraph 4.71), we rounded volume purchases and excluded all outliers. We conducted statistical tests of price variation of drugs over a calendar year and of potential variation in prices caused by possible differences in the costs of drugs between provinces. We found the price differences to be minimal.

Criteria

Like the audit objectives, criteria for this audit were developed by the Canadian Council of Legislative Auditors (CCOLA). Common objectives and criteria were used as a means of standardizing the concurrent audits of respective drug programs of the federal, provincial, and territorial governments. The pertinent criteria reported against in this audit are as follows:

- The objectives of the program should encompass the entire program mission. They should be well defined, measurable, and periodically reviewed.
- Adequate performance information should be available to measure whether the program's mission statement and objectives are being achieved.
- An adequate responsibility framework should be put in place with the third-party service provider in order to evaluate the effectiveness of its services (expectations, appraisal, and ways to account).
- Adequate procedures should be in place to ensure compliance with legislation and policies and to take corrective action when necessary.
- Drugs to be listed should be properly assessed to ensure that they are cost-effective.
- Drugs listed should be regularly evaluated to determine whether they should be retained, deleted, or restricted in their use, and corrective action should be taken when necessary.
- Policies and processes should be in place to ensure that listed drugs and pharmacy services are acquired at the lowest possible cost (including use of competitive processes, generic drugs, and volume discounts).
- Prices of drugs should be followed up and analyzed and, if necessary, audited.
- Prescribing practices should be monitored to assess and, to the extent practical, determine whether they are appropriate and economical.
- Procedures should be in place to encourage improved prescribing practices for doctors.
- Procedures should be in place to monitor and analyze drug use and to take corrective action when necessary (for example, over-prescribing and potential drug interaction).
- Adequate procedures should be in place to identify and prioritize pharmacies for audits.
- Audits should be consistently conducted and, where applicable, recoveries should be made on a timely basis.
- The organization should have reasonable assurance that the pharmacy payment system processes only valid claims accurately, consistently, and on a timely basis, and that the amounts paid to pharmacies comply with the policies and legislation.
- The reported information should be presented to Parliament/legislature in the prescribed timeframe.
- Health Canada should have taken appropriate action on the Office of the Auditor General's 2000 follow-up audit of the Department's drug benefit program.
- Veterans Affairs Canada should have taken appropriate action on the Office of the Auditor General's 1998 follow-up audit of the Department's drug benefit program.

Other related audit work

See the following reports of the Auditor General: Chapter 13, Health Canada—First Nations Health (October 1997); Chapter 15, Health Canada—First Nations Health Follow-Up (October 2000); Chapter 12, Veterans Affairs Canada—Health Care (May 1996); and Chapter 28, Veterans Affairs Canada—Health Care Follow-up (December 1998).

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Appendix Follow-up of previous audits

2000 Office of the Auditor General recommendation	2001 Public Accounts Committee recommendation	Our assessment	Progress to date
Health Canada should more closely monitor pharmacists' overrides of drug utilization messages and undertake rigorous analysis on an ongoing basis to assess the effectiveness of the messages.	That Health Canada regularly analyze overrides of warning messages generated by the point-of-service system to determine whether warning messages are effective, whether prescriptions rejected by some pharmacists have been filled by others, and how and why clients with very large numbers of prescriptions are getting through the system.	●	Health Canada continues to monitor overrides of warning messages and uses that information to determine which provider should be audited. (see paragraph 4.29)
	That Health Canada include a discussion of its analysis of pharmacists' overrides along with subsequent action taken in response to that analysis in its performance reports beginning with the report for the period ending 31 March 2002.	●	Health Canada has reported in its performance report on the analysis of pharmacists' overrides and action taken. (see paragraph 4.29)
	That Health Canada immediately upgrade the point-of-service system for pharmacies under the Non-Insured Health Benefits Program so that the system provides the dates, quantities, and drugs prescribed of at least a client's last three prescriptions and information on doctor visited.	○	The data extracted from the point-of-service system in Health Canada have not been updated as requested by the Public Accounts Committee. (see paragraph 4.34)
In cases where it identifies a significant pattern of inappropriate use of prescription drugs, Health Canada should continue to perform rigorous follow-up with Non-Insured Health Benefits clients, physicians, pharmacists, and professional bodies. Health Canada should ensure that it has the means to implement this action.	That Health Canada implement a centralized analysis of drug use similar to that found in the provinces in order to identify misuse, abuse, and multiple use on a real-time basis.	○	Clients at Health Canada continue to access large numbers of prescription drugs. Information drawn from the overrides is not used to conduct drug utilization review and monitor patient safety. (see paragraph 4.33)
	That Health Canada develop a policy to guide its response in cases where it is unable to obtain the consent of recipients of Non-Insured Health Benefits to share information on use of pharmaceuticals with health care professionals and make that policy known prior to the implementation of a client consent arrangement under the Non-Insured Health Benefits Program.	◓	Health Canada has discontinued analysis of inappropriate drug use due to privacy concerns, despite the fact that sharing of client profiles is not necessary. (see paragraph 4.46)
	That Health Canada explore ways of facilitating the sharing of information between individual pharmacists and physicians providing services under the Non-Insured Health Benefits Program and report its conclusions to the Committee by 31 March 2002.		

● Fully addressed ◓ Satisfactory progress ○ Unsatisfactory progress

2000 Office of the Auditor General recommendation	2001 Public Accounts Committee recommendation	Our assessment	Progress to date
	That Health Canada ask the government to amend the *Privacy Act* if necessary in order to clarify that health care providers can share the personal medical information of individuals among other health care providers.		
	That Health Canada review the option of obtaining specific enabling legislation for the Non-Insured Health Benefits Program that would, among other things, permit sharing of information about client drug prescription patterns among health care professionals, and report the conclusions of that review to the Committee by 31 March 2002.		
Health Canada should enforce the contract requirements for audit of pharmacy and dental care providers and reporting by the contractor. The Department should continue to take steps to strengthen verification of claims and audit of providers.	That Health Canada include the evaluation plans for community health programs and the Non-Insured Health Benefits Program in its Report on Plans and Priorities, beginning with the report for the fiscal year 2002–03.	◓	Health Canada has taken steps to address overpayment. Next-day claim verification and pharmacy audits have resulted in the prevention, detection, and recovery of overpayment. (see paragraphs 4.99 and 4.102)

1996 Office of the Auditor General recommendation	2001 Public Accounts Committee recommendation	Our assessment	Progress to date
Veterans Affairs Canada should develop and implement a plan to realize the benefits of the revised drug formulary and improved drug-monitoring system.		●	Veterans Affairs Canada completely overhauled its formulary and implemented a claims processing system in 1997–98. (see paragraphs 4.31)
Veterans Affairs Canada should explore less costly means of providing over-the-counter medication to clients.		◓	The Department has explored less costly means of providing over-the-counter drugs but has not implemented a process that would lead to significant cost savings. (see paragraphs 4.93)

● Fully addressed ◓ Satisfactory progress ○ Unsatisfactory progress

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2004

Report of the

Auditor General of Canada

to the House of Commons

NOVEMBER

Chapter 5

Indian and Northern Affairs Canada—
Education Program and
Post-Secondary Student Support

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

5

Indian and Northern Affairs Canada

Education Program and Post-Secondary Student Support

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Indian and Northern Affairs Canada
Education Program and Post-Secondary Student Support

Main Points

5.1 Although Indian and Northern Affairs Canada carried out more studies and undertook several new initiatives in elementary and secondary education, it made limited progress in addressing most of the issues and recommendations raised in our April 2000 Report and in the June 2000 Report of the Standing Committee on Public Accounts. The Department does not know whether funding to First Nations is sufficient to meet the education standards it has set and whether the results achieved are in line with the resources provided. The budget for this program is over $1 billion annually.

5.2 We remain concerned that a significant education gap exists between First Nations people living on reserves and the Canadian population as a whole and that the time estimated to close this gap has increased slightly, from about 27 to 28 years.

5.3 The number of First Nations people having a post-secondary certificate, diploma, or degree continues to grow. However, we found significant weaknesses concerning the Post-Secondary Student Support Program's management and accountability framework. The Department has not clearly defined its roles and responsibilities. The way it allocates funds to First Nations does not ensure equitable access to as many students as possible, and the Department does not know whether the funds allocated have been used for the purpose intended. In addition, the information available on the performance of the program is inadequate. As a result, the Department does not know whether program funds are sufficient to support all eligible students, and it has no assurance that only eligible students taking eligible courses are receiving funding. The budget for this program is about $273 million a year.

5.4 We also noted discrepancies in the information that the Department provided to the Treasury Board about the way the program operates. Moreover, Parliament is not receiving a complete picture of the program and how effective it has been in narrowing the gap in post-secondary education between First Nations and the Canadian population as a whole.

5.5 The Department is currently carrying out a comprehensive review of all its policy and program delivery authorities, including its education programs. This exercise provides the Department and central agencies, in consultation with First Nations and other parties, an opportunity to take a fresh look at the programs' design, administration, and accountability for and reporting of results.

Background and other observations

5.6 The elementary and secondary education of children living on reserves is covered by various statutes, treaties, agreements, and government policy, and it involves numerous players. Indian and Northern Affairs Canada and central agencies establish funding levels, education policy, and delivery requirements. The Department also operates seven schools. Under various funding arrangements with the Department, First Nations deliver education on reserves, arrange to buy education services from local school boards, or use a combination of both. Provinces and school boards provide education to on-reserve children attending schools outside their community. Some students attend private schools. At the post-secondary level, the Department transfers funds to First Nations to provide financial assistance to eligible students, living on or off reserves, to defray the cost of tuition, books, and supplies. When applicable, financial assistance also covers travel and living expenses for full-time students and their dependents.

5.7 Many First Nations students and communities face fundamental issues and challenges that are more prevalent for them than for other Canadians and may impede their educational achievement. For example, most First Nations communities are small, with fewer than 500 residents. Thus, their schools have difficulty providing a range of educational services.

5.8 In addition, the First Nations population is young and growing. According to the Department, about 40 percent of the Registered Indian population is under the age of 19, compared with 25 percent for the Canadian population. The Department projects that the on-reserve Registered Indian population will grow from about 445,000 in 2003 to 700,000 by 2021.

5.9 Education is critical to improving the social and economic strength of First Nations individuals and communities to a level enjoyed by other Canadians. All parties, including the Department, First Nations, provinces, school boards, parents, and the students, need to work together to improve results. We believe that the Department needs to take a leadership role in addressing long-standing issues affecting First Nations education. In particular, the Department needs to urgently define its own role and responsibilities and improve its operational performance and reporting of results.

The Department has responded. The Department accepts all the recommendations. It reiterates its commitment to working with First Nations and other stakeholders to improve the educational outcomes of First Nations students and states that success in First Nations education must be measured over the long term.

Introduction

Value and provision of education

5.10 Education is critical to improving the social and economic strength of First Nations individuals and communities to a level enjoyed by other Canadians. In April 2000, we reported a significant gap in educational achievement, measured by secondary school graduation, between First Nations peoples living on reserves and the overall Canadian population.

5.11 Numerous studies have stressed the importance and benefits of post-secondary education. The Royal Commission on Aboriginal Peoples linked it to capacity building, human resource development, and self-government. A Human Resources Development Canada study in 2002 estimated that more than 70 percent of the new jobs created in Canada require some form of post-secondary education. This fact is particularly significant for First Nations people because, compared with the Canadian population as a whole, a much smaller proportion of them hold a post-secondary certificate, diploma, or degree.

5.12 First Nations and their organizations believe that education is a treaty right that covers all education levels, including post-secondary. The federal government does not agree with this position. The Department's elementary and secondary programs are guided by various statutes, treaties, agreements, and government policy. At the post-secondary level, the government considers that assistance to First Nations students results from policy.

5.13 The elementary and secondary education of children living on reserves involves numerous players. At the federal level, Indian and Northern Affairs Canada and central agencies establish funding levels, education policy, and delivery requirements. The Department also operates seven schools on reserves. Under various funding arrangements with the Department, First Nations deliver education on reserves, arrange to buy education services from local school boards, or use a combination of both. Provinces and school boards provide education to on-reserve children attending schools outside their community. Some students attend private schools. Parents and families are expected to be involved in their children's education, and students are required to attend school for at least as long as the mandatory requirement of their province of residence.

Issues and challenges in First Nations education

5.14 Many First Nations students and communities face fundamental issues and challenges that are more prevalent for them than for other Canadians and may impede their educational achievement. These include health problems, poor economic conditions, racism, and issues related to geography and demography (see Appendix A for more details). Yet, despite these impediments, we noted examples of successful elementary and secondary education initiatives by First Nations, such as the First Nations Education Steering Committee in British Columbia (see Successful First Nations initiatives in education). Other regions could benefit from adopting similar practices.

Successful First Nations initiatives in education

The First Nations Education Steering Committee, a not-for-profit organization, was established in May 1992 to facilitate discussion about education matters affecting First Nations in British Columbia. It provides relevant and up-to-date information to First Nations about federal and provincial government policies and programs, undertakes research to support First Nations education, and communicates with the federal and provincial governments to ensure that First Nations concerns are being addressed. About 60 First Nations education technicians representing First Nations communities from throughout the province provide direction for the steering committee's activities.

The steering committee administers a number of components of the on-reserve education program, including the Special Education Program, band school evaluations (or assessments), and the education reform initiative under Gathering Strength. In those three cases, the steering committee allocates funds to member First Nations, analyzes and approves project proposals, reviews project reports, and assesses project results. In addition, it provides support to First Nations on professional development, teacher recruitment, and capacity building. It produces studies and discussion papers on issues affecting education for First Nations and on best practices observed throughout the province.

In 2001–02, the steering committee's budget totalled $11.9 million and was funded mainly by Indian and Northern Affairs Canada. About $9 million was allocated directly to First Nations communities. The largest portion, $2.3 million, went to Gathering Strength projects, $1.1 million went to the Special Education Program, and $185,000 was allocated for band school assessments.

Both departmental regional officials and First Nations representatives told us that they are very satisfied with the quality and breadth of services provided by the steering committee. A recent evaluation of the organization also found high levels of stakeholder satisfaction in the quality of the steering committee's programs and services and in the organization's methods of ensuring community input and direction. It also concluded that the steering committee represents First Nations in British Columbia on education matters.

Source: First Nations Education Steering Committee documentation; discussions with steering committee and Indian and Northern Affairs Canada officials from British Columbia (unaudited)

Departmental programs and funding

5.15 **Elementary and secondary education.** At about $1.1 billion annually, elementary and secondary education continues to be the largest program area of Indian and Northern Affairs Canada, representing over 20 percent of the Department's budget for 2003–04. In addition, the Department spends about $213 million annually on educational facilities. Funding is also provided for teacher pensions and band administration support related to education, but the Department does not track this funding separately. During 2002–03, education funding supported about 120,000 students, of which about 60 percent attended schools located on reserves (there are 503 such schools and First Nations manage all but 7) and 40 percent attended provincial or private schools.

5.16 The Department provides money to band councils or other First Nations education authorities to support instructional services, from kindergarten through to adult learners, for people residing on reserves. The money is provided through various funding agreements and pays for the costs of on-reserve students attending schools (on or off reserves); student support

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5.16 The Department provides money to band councils or other First Nations education authorities to support instructional services, from kindergarten through to adult learners, for people residing on reserves. The money is provided through various funding agreements and pays for the costs of on-reserve students attending schools (on or off reserves); student support services such as transportation, counselling, accommodation, and financial assistance; school administration and evaluation; and First Nations school boards. Under current departmental policy, First Nations schools are required, at a minimum, to follow provincially recognized programs of study, hire provincially certified teachers, and follow education standards that allow students to transfer to an equivalent grade in another school within the province in which the reserve is located.

5.17 **Post-Secondary Student Support Program.** This program is intended to provide financial assistance to eligible students to defray the cost of tuition, books, and supplies. When applicable, the program also helps to cover travel and living expenses for full-time students and their dependents. The amount of assistance is not tied to the student's income or that of his or her parents or spouse. To be eligible for assistance, a student must be an Inuit or a Registered Indian who ordinarily lives in Canada, either on or off reserves, is enrolled in a provincially accredited post-secondary education program or a university or college entrance preparation program, and maintains satisfactory academic standing. The program also covers the cost of providing post-secondary guidance and counselling services. The Department provides most of the program funds to First Nations through various funding agreements and expects them to use these funds in accordance with the conditions defined in these agreements. Appendix B outlines the chronology of the Department's assistance to First Nations post-secondary students.

5.18 We calculated that between 1994–95 and 2003–04, Indian and Northern Affairs Canada allocated almost $2.8 billion to First Nations post-secondary education, including about $304 million in 2003–04. About 90 percent of this funding was earmarked for the Post-Secondary Student Support Program. We calculated that about 30,000 students supported by the program graduated between 1994–95 and 2001–02. The Department reported that more than 25,000 First Nations and Inuit people had received assistance in 2002–03.

Focus of the audit

5.19 This chapter reports the findings of two distinct audits that provide a more comprehensive look at the Department's support of First Nations education.

- The first audit is a follow-up of our audit of Indian and Northern Affairs Canada's elementary and secondary education program reported in April 2000. This audit focussed on the extent of progress the Department has made in addressing the issues and recommendations raised in our April 2000 Report as well as those raised in the June 2000 Report of the Standing Committee on Public Accounts concerning elementary and secondary education.
- The second audit covers the Department's Post-Secondary Student Support Program. The audit examined the Department's management of the program. Our objectives were to determine whether the Department had a clear policy and objective for the program, whether the systems and procedures to support program implementation were

consistent with the program's policy and objective, and whether relevant information was reported to Parliament.

5.20 Further details on the objectives, scope, approach, and criteria of the audits are included in **About the Audit** at the end of the chapter.

Observations and Recommendations

Elementary and secondary education follow-up

What we reported in 2000

5.21 In April 2000, we reported that Indian and Northern Affairs Canada could not demonstrate whether it was meeting its stated objective to assist First Nations living on reserves in achieving their education needs and aspirations. We noted that the progress in closing the education gap between First Nations people living on reserves and the overall Canadian population had been unacceptably slow and that immediate action needed to be taken to close this gap. The audit also found that the Department needed to articulate its role in education, take action to resolve outstanding issues, develop and use appropriate performance measures, and improve its operational performance.

5.22 The Standing Committee on Public Accounts held hearings on the audit and issued its report to Parliament in June 2000. The Committee expressed serious concern about the unacceptable state of First Nations elementary and secondary education and criticized the Department's "hands-off" management approach. While agreeing with the principle of devolution, the Committee insisted that this principle must be accompanied with clearly defined roles and responsibilities agreed to by all parties. The Committee recognized that the Department had a broad understanding of the issues involved, and it expected the Department to quickly demonstrate real progress in addressing the shortcomings identified in the audit. The Committee also requested the Department to report on its progress in its performance report, beginning with the 2001 *Performance Report* (covering the fiscal year ending 31 March 2001).

5.23 The Department generally agreed with the Committee's recommendations and committed to working with its partners to address them. The Department did not fully agree to report its progress in its performance report. Instead, it agreed to publish a biennial report on First Nations education beginning in 2002–03 and to include key indicators from this report in its performance report.

Meaningful results are still lacking

5.24 In 2000 we noted a lack of meaningful action to address the findings of numerous reports and studies. We recommended that action plans be implemented promptly. The plans were to identify the costs and funding responsibilities as well as how and by whom action would be taken and the time frames. We also recommended that the Department demonstrate how its initiatives, including Gathering Strength—Canada's Aboriginal Action Plan would address long-standing issues and improve First Nations education.

5.25 Given the Department's stated commitments, we expected that it would have developed and implemented a detailed strategy and action plan to implement measures for improvement and to monitor progress.

5.26 We noted several developments since our 2000 audit. Exhibit 5.1 summarizes these developments, together with their status. Some of these were undertaken to address our recommendations or those of the Public Accounts Committee. Others were for existing or new education programs, the renewal of education authorities, additional studies, and changes in the Department's organization. However, we found that, with few exceptions, such as special education, the Department has made limited progress since 2000. The Department has generally continued the same practices for the way it supports, administers, and reports the elementary and secondary education programs for students living on reserves. Program terms and conditions, funding allocation, and reporting requirements have mainly remained unchanged.

A large education gap remains

5.27 In 2000 we used figures reported by the Department in its Estimates documents to estimate that it would take 23 years to close the education gap between First Nations people living on reserves and the Canadian population as a whole. Our estimate assumed that the proportion of Canadians with high-school education would not change from its 1996 level.

5.28 The Department acknowledged the importance of closing this gap. It claimed that its education reform projects and other corrective measures already underway would lead to progress, and that the gap would be closed earlier than we had estimated.

5.29 We recalculated the gap that existed in 1996 (and reported in 2000), using more precise data from the 1991 and 1996 censuses. Without changing our assumptions, we estimated that the time needed to close the education gap that existed in 1996, and for First Nations people living on reserves to reach parity with the overall Canadian population, was about 27 years rather than the 23 years that we had originally estimated.

5.30 We also calculated the education gap that existed in 2001, using data from the 1996 and 2001 censuses, and estimated the time to close that gap and for First Nations people living on reserves to reach parity with the Canadian population as a whole. We found that the proportion of First Nations people living on reserves over the age of 15 with at least a high-school diploma increased by 4.8 percent between 1996 and 2001, while that same proportion in the overall Canadian population increased by 3.5 percent. Although the gap has narrowed by 1.3 percent during this period, the rate of improvement for First Nations people living on reserves slowed compared with the previous five-year period, while that of the Canadian population as a

Exhibit 5.1 Developments since our 2000 audit of Indian and Northern Affairs Canada's elementary and secondary education program

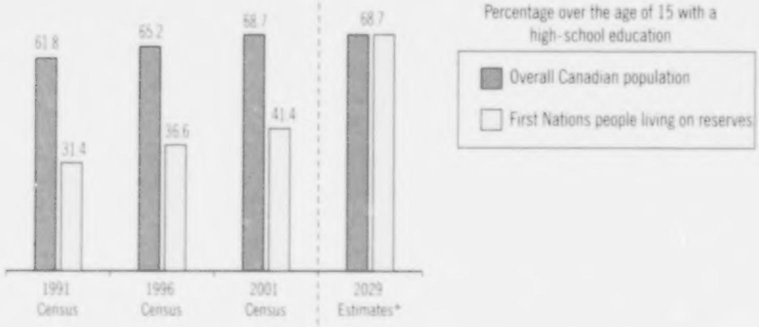
Activities	Status as of August 2004
Actions related to our 2000 audit	
Roles and responsibilities. In 2000–01, the Department committed to working with all parties to better articulate its roles in education. In response to the Public Accounts Committee report, the Department committed to issuing, in collaboration with First Nations, a statement on its roles and responsibilities by June 2002. In late 2001, a departmental committee produced a first draft and, in early 2002, the Department appointed a senior executive to continue this work. Numerous drafts have been produced but no final decision has been made. The Education Branch has taken over responsibility for developing a statement on the roles and responsibilities in First Nations education.	The Department has not established a plan to clarify its roles and responsibilities.
Biennial report. In 2000–01, the Department made a commitment to the Public Accounts Committee to publish a biennial report on First Nations education, starting in 2002–03. The report was to provide a clear record of progress in closing the education gap.	The Department has published its first biennial report in 2004.
Compliance regime. Since our audit, the Department told us that it has updated its compliance regime for management of the education programs. This regime is aimed at increasing accountability and conformity with the program terms and conditions.	The Department sent draft compliance guidelines to the regions in spring 2004.
Student tracing methodology. In 2002–03, the Department began to develop a tracing methodology to follow the progression of students it funds to the end of their education. This will help First Nations, educators, and researchers understand the factors related to educational outcomes of the students and help clarify policy and program decisions.	The Department is continuing work on the tracing methodology.
Renewal of authorities	
The 2000 Treasury Board policy on transfer payments triggered a comprehensive renewal of all the Department's policy and program delivery authorities, including the authority for its education programs. According to the Department, the renewal of the education authority marked the first time in over 100 years that detailed terms and conditions were set out for the delivery of the Department's education program. The renewal exercise identified significant "anomalous practices" that were inconsistent with existing policy and program delivery authorities. To correct the problem, the government granted the Department interim authority to enable existing practices to continue, pending a comprehensive review of the education programs. We noted that on two occasions the Department did not meet its own deadline to complete the review and sought extension of its interim authority from the government.	Under its latest plan, the Department is to bring a proposal to the government for renewing education policy and programs by October 2005.
Education reform initiatives	
In 1998 the Government of Canada responded to the Royal Commission on Aboriginal Peoples with a long-term, broad-based policy approach designed to increase the quality of life of First Nations people and to promote self-sufficiency. The plan, Gathering Strength, contained an education reform component, with resources to improve the quality of education in First Nations schools and the academic achievement of First Nations students. According to departmental figures, between 1998 and 2003 the Department spent $176 million on about 1,300 education reform projects proposed by First Nations and their organizations along four jointly defined priorities. Gathering Strength ended in March 2003, along with its education reform component. It was replaced in April 2003 by a similar initiative, New Paths for Education, with an annual budget of $40 million.	The Department has not evaluated this initiative. It does not know whether it achieved its intended objectives. It is implementing New Paths for Education.
New studies	
Minister's National Working Group on Education. In June 2002, the Minister of Indian and Northern Affairs created a National Working Group on Education. This group, made up of 15 First Nations people with experience in education, was asked to provide the Minister with concrete recommendations on how to improve First Nations education, and on how the Department could work with First Nations to implement those changes and close the education gap. As part of the group's work, new research was conducted in 11 areas, including jurisdiction, funding, education philosophy, infrastructure, teacher recruitment, and parental involvement. The group's report, *Our Children—Keepers of the Sacred Knowledge*, was made public in February 2003. The report found "First Nations education in a crisis" and made 27 recommendations aimed at improving the situation.	Departmental officials state that they are working with First Nations on the key issues in the working group's report.

Exhibit 5.1 Developments since our 2000 audit of Indian and Northern Affairs Canada's elementary and secondary education program (cont'd)

Activities	Status as of August 2004
A-base review. Education program funding was part of the A-base review that the Department completed in 2003. This initiative was intended to draw a clear relationship between existing resources and results, to identify an approach to achieve a streamlined and integrative authorities structure, and to support the Department's planned move to a more dynamic and flexible management model.	The findings of the review are to help support the education policy review.
Cost studies. Since 2000, the Department undertook or funded additional studies to compare the funding levels it provides to First Nations with what provinces provide to their school boards. These studies noted discrepancies in funding levels and identified potential factors that could explain these variations. However, like the previous studies carried out on costs, they were not endorsed by the Department.	Further studies on costs are planned. Discussions are taking place with First Nations on the funding formula.
Audit on teacher certification. An audit on teacher certification was completed in 2003. The audit found weaknesses in the management control framework for ensuring that education standards in on-reserve schools are met. In particular, what makes up a "comparable curriculum" has not been defined in practical terms.	The Department has approved and is implementing an action plan to address recommendations.
Evaluation of federal and band-operated schools. The evaluation will include a review of the resource allocation methodologies for these schools. The Department intends to use the evaluation to inform further program and policy review.	The Department's target date for completion is fall 2004.
New programs	
Special education. A program dedicated to special education was approved in January 2003. It is designed to improve the achievement levels of First Nations on-reserve special education students by providing access to special education programs and services that are culturally sensitive and meet the provincial standards in the locality of the First Nation. An initial budget of $52 million was approved for 2002–03, which will increase to $95 million by 2005–06 as a result of some existing education funding being redirected on an annual basis.	The Department is implementing the program.
Teacher salaries. This new program, created in response to recommendations contained in the report of the Minister's National Working Group on Education, was approved in August 2003, and is intended to supplement teacher salaries in band-operated schools. The program has an annual budget of $15 million in 2004–05.	The Department is implementing the program as a pilot project.
Parental involvement. This new program, also created in response to recommendations contained in the report of the Minister's working group, is intended to promote parental engagement in First Nations communities. The program, approved in August 2003, has an annual budget of $5 million in 2004–05.	The Department is implementing the program as a pilot project.
Reorganization	
Regional Operations Support and Services (ROSS). In 2003–04, the Department created a new sector intended to oversee monitoring and compliance and to ensure consistency and accountability in departmental programs across the regions.	The Department has approved additions to staff and is developing business practices.
Education Branch at headquarters. In 2003–04, the Department created the Education Branch at its headquarters and increased the number of staff working on education matters. This branch is responsible for looking after education and for delivering the Department's external and internal commitments to modify the education program.	The Department has developed specific roles and responsibilities for the branch and its staff.
Regional education directorate. In one region that we visited, an education directorate was created in 2001 to bring more focus to the regional education responsibilities. Another region was considering the creation of a similar structure at the time of our audit, while a third region was in the process of creating a position dedicated to managing the education programs.	Regions consider that there is insufficient staff dedicated to education. The Department has no plans to increase staff in the regions.

Source: Discussions with departmental and First Nations officials; departmental response to our 2000 audit; government response to the 2000 Public Accounts Committee Report; and departmental and non-departmental documents (unaudited) whole grew slightly. As a result, we estimate that it would take about 28 years for First Nations people living on reserves to reach parity with the Canadian population (Exhibit 5.2).

Exhibit 5.2 The education gap between First Nations people living on reserves and the overall Canadian population



*This calculation assumes that the First Nations rate of improvement between two censuses remains the same and that the proportion of Canadians with high-school education stays constant.

Source: Census data from the 1991, 1996, and 2001 censuses (unaudited)

5.31 Because the Department has not used a consistent methodology to monitor the gap, it could not explain the decrease in the rate of improvement of First Nations students living on reserves between the periods covered by the 1996 and 2001 censuses. The Department informed us that it is working on various approaches that would allow it to compare First Nations communities with non-First Nations communities sharing similar attributes, such as location, instead of relying on global comparisons.

5.32 The need to close the education gap is even more urgent today given the current and projected demographics in First Nations communities. According to the Department, about 40 percent of the Registered Indian population is under the age of 19, compared with 25 percent for the overall Canadian population. The Department also projects that the on-reserve Registered Indian population will grow from about 445,000 in 2003 to about 700,000 by 2021, an estimated growth rate significantly higher than that of the Canadian population. In our view, failure to address the gap continues to have significant consequences for First Nations people living on reserves because they do not have access to the benefits associated with a higher level of education.

5.33 **Recommendation**. Indian and Northern Affairs Canada, in consultation with First Nations, should immediately develop and implement a comprehensive strategy and action plan, with targets, to close the education gap. It should also report progress to Parliament and to First Nations on a timely basis.

Department's response. Indian and Northern Affairs Canada is working with First Nations on a review of key elements of the elementary and secondary education programs. As well, the Department is leading the follow-up work to the April 2004 Canada—Aboriginal Peoples Roundtable on lifelong learning, building on past studies such as the Royal Commission on Aboriginal Peoples and the National Working Group on Education. The Department is also actively participating in preparations for the other roundtables on health, housing, economic opportunities, negotiations, and accountability. The Department will continue to report to Parliament through the performance report, the report on plans and priorities, and the Aboriginal Report Card the prime minister has committed to produce. These will provide the Department and First Nations with an opportunity to jointly develop key indicators, report on progress, and identify areas where more work is needed.

The Department has not yet defined its roles and responsibilities

5.34 During our 2000 audit, we could not find any formal document that clearly defined the Department's roles or responsibilities in education. We believed that because many stakeholders have an interest in education, the Department needed to articulate and communicate its roles to other parties, while also taking into account their various roles. The Public Accounts Committee also expressed concern about the Department's lack of clearly defined roles in the delivery of education services to First Nations and noted considerable ambiguity and inconsistency in the way the Department carried out its mandate.

5.35 The Department agreed with our recommendation and committed to working with all parties to better articulate its roles in education. In response to the Public Accounts Committee report, the Department committed to issuing, with the collaboration of First Nations, a statement on its roles and responsibilities by June 2002.

5.36 This statement has not been issued and there is still no consensus within the Department about its roles and responsibilities. We noted that the Department has not carried out an analysis of the various legislative authorities and obligations to determine the minimum roles it should play and the level of services it should fund. We believe that such an analysis is important and could be a starting point in defining the Department's roles and responsibilities and guiding discussions with other parties.

5.37 At the operational level, we found that there is still ambiguity and inconsistency in the role of regional offices in fulfilling the Department's mandate and achieving its education objectives. The Department expects that the education delivered in schools located on reserves is comparable with what provinces offer off reserves and that students are able to transfer from band-operated to provincial schools without academic penalty. However, a number of school evaluations we reviewed clearly indicated that some students do not perform at their current grade level, suggesting that they cannot transfer to the same grade in the provincial education system. Yet, we saw no evidence that the regions consider this information in assessing whether First Nations meet the terms and conditions of their funding agreement and whether corrective action is required. Most regions continue to interpret their major role as that of providing a funding service.

5.38 In addition, we noted that some provinces do not recognize the educational achievement of grade 12 students attending on-reserve schools unless these schools have been provincially accredited or students pass a provincially recognized test.

5.39 The extent of freedom that parents have to choose their children's school also illustrates how unclear roles and responsibilities can lead to inconsistency in program delivery. While the Department and First Nations want parents to be involved in their children's education, regions take different approaches concerning parental choice of school. In one region, the Department has extended the parents' freedom to the point of fully funding transportation to the school of choice, whether band-operated, federal, or provincial. Other regions consider that when there is a school on the reserve, parents should send their children to that school. Accordingly, they do not cover the difference in tuition costs; nor do they provide transportation if parents choose to send their children off the reserve.

5.40 Our 2000 report presented the Mi'kmaq Education Agreement as a case study to illustrate initiatives that affected First Nations education powers and responsibilities. In this follow-up, we examined progress in implementing this agreement, which transferred jurisdiction over education to nine Mi'kmaq communities in Nova Scotia. We found that the Department and the participating First Nations lack a common understanding of their roles and responsibilities and that the agreement is ambiguous (see The Mi'kmaq Education Agreement, page 13).

5.41 We are concerned about the Department's lack of progress in defining its roles and responsibilities. In our view, until the Department clarifies these and its capacity to fulfill them, and reaches a consensus with other parties on their own roles and responsibilities, it will remain difficult to make progress in First Nations education and close the education gap.

5.42 **Recommendation**. Indian and Northern Affairs Canada should clearly define and document its roles in education while taking into account its basic legal responsibilities and the roles of other parties. The Department should provide its regional offices with sufficient guidance and training to ensure that its roles and responsibilities are understood and applied consistently.

Department's response. Indian and Northern Affairs Canada continues to work on defining its roles in education. While this appears to be a straightforward task, it is more complex because of the number of stakeholders and their diverging views about the Department's current mandate in First Nations education matters and how this mandate should evolve to support First Nations control of First Nations education. The process that led to the creation of the Education Branch in early 2004 has laid the groundwork for defining the Department's roles and responsibilities in First Nations education. The Regional Operations Support and Services

The Mi'kmaq Education Agreement

The Mi'kmaq Education Agreement was enshrined in federal and Nova Scotia law in 1999. The legislation gave each of the nine participating communities the power to make laws related to primary, elementary, and secondary education that would be applicable on their reserves. It also created a corporation, the Mi'kmaw Kina'matnewey (MK), to support them in the delivery of education.

What we found in 2000. In 2000 we reported on potential lessons learned from the Mi'kmaq Education Agreement, including the preparedness of the First Nations on governance, accountability, pedagogical, and financial matters. We also noted that the implementation of the agreement was not being reviewed as planned.

What we found in this audit. Since 2000, the participating communities have continued to deliver education under the agreement. They have also developed a curriculum to teach the Mi'kmaq language and have built or expanded schools. The Department, the participating communities, and the MK agreed in 2002 to extend the initial agreement for a three-year period; it will expire in March 2005. They have also begun discussions to renew the agreement for another five-year period to begin in April 2005. One of the four communities that initially chose not to participate in the agreement joined in 2003. A joint evaluation of the result of the agreement was being completed at the end of our fieldwork.

We noted that the parties lack a common understanding of the meaning and the implications of "First Nations jurisdiction" over education. For example, the parties disagree on how levels of capital funding should be determined. Under the *Mi'kmaq Education Act*, First Nations can exercise jurisdiction on reserves only. Participating First Nations argue that capital funding should be established so that they can accommodate students attending off-reserve schools in the communities' local schools. Some of these First Nations built or enlarged schools in order to do that, but without departmental funds. The Department argues that it continues to have power to determine capital funding and, in making these decisions, it uses the practices applicable to First Nations under the *Indian Act*.

Another example of disagreement relates to accessing new departmental programs. When the Department introduced special education or teachers' salary programs, participating communities were subject to the same program terms and conditions as other First Nations, as if they did not have jurisdiction. Participating First Nations believe that when the Department introduces new education programs, they should have access to additional funds while continuing to exercise jurisdiction over the use of these funds.

We also noted ambiguities in the implementation of the agreement. For example, the Department and participating First Nations have not determined the information required to account for the results of this transfer of jurisdiction. The Department has not defined the information it needs in the context of a government-to-government relationship in the field of education. It continues to receive from participating First Nations the same financial information and some of the non-financial information it was receiving before the agreement. In addition, the parties have not defined what information is needed to assess education performance and its comparability with other provincial systems, as intended in the legislation.

Conclusion. The Department and participating First Nations need to review the agreement and its implementation and resolve disagreements. Since the Mi'kmaq Agreement has become a model for other "education self-government agreements" in the country, what is learned in the implementation of this agreement can bring valuable lessons for the future.

The Mi'kmaq Education Agreement

The Mi'kmaq Education Agreement was enshrined in federal and Nova Scotia law in 1999. The legislation gave each of the nine participating communities the power to make laws related to primary, elementary, and secondary education that would be applicable on their reserves. It also created a corporation, the Mi'kmaw Kina'matnewey (MK), to support them in the delivery of education.

What we found in 2000. In 2000 we reported on potential lessons learned from the Mi'kmaq Education Agreement, including the preparedness of the First Nations on governance, accountability, pedagogical, and financial matters. We also noted that the implementation of the agreement was not being reviewed as planned.

What we found in this audit. Since 2000, the participating communities have continued to deliver education under this agreement. They have also developed a curriculum to teach the Mi'kmaq language and have built or expanded schools. The Department, the participating communities, and the MK agreed in 2002 to extend the initial agreement for a three-year period; it will expire in March 2005. They have also begun discussions to renew the agreement for another five-year period to begin in April 2005. One of the four communities that initially chose not to participate in the agreement joined in 2003. A joint evaluation of the results of the agreement was being completed at the end of our fieldwork.

We noted that the parties lack a common understanding of the meaning and the implications of "First Nations jurisdiction" over education. For example, the parties disagree on how levels of capital funding should be determined. Under the *Mi'kmaq Education Act*, First Nations can exercise jurisdiction on reserves only. Participating First Nations argue that capital funding should be established so that they can accommodate students attending off-reserve schools in the communities' local schools. Some of these First Nations built or enlarged schools in order to do that, but without departmental funds. The Department argues that it continues to have power to determine capital funding and, in making these decisions, it uses the practices applicable to First Nations under the *Indian Act*.

Another example of disagreement relates to accessing new departmental programs. When the Department introduced special education and teachers' salary programs, participating communities were subject to the same program terms and conditions as other First Nations, as if they did not have jurisdiction. Participating First Nations believe that when the Department introduces new education programs, they should have access to additional funds while continuing to exercise jurisdiction over the use of these funds.

We also noted ambiguities in the implementation of the agreement. For example, the Department and participating First Nations have not determined the information required to account for the results of this transfer of jurisdiction. The Department has not defined the information it needs in the context of a government-to-government relationship in the field of education. It continues to receive from participating First Nations the same financial information and some of the non-financial information it was receiving before the agreement. In addition, the parties have not defined what information is needed to assess education performance and its comparability with other provincial systems, as intended in the agreement.

Conclusion. The Department and participating First Nations need to review the agreement and its implementation and resolve disagreements. Since the Mi'kmaq Agreement has become a model for other education self-government agreements in the country, what is learned in the assessment of results of this agreement can bring valuable lessons for the future.

Sector, created in 2003–04 to ensure consistency and coherence across the regions, will help regional offices understand and consistently apply their roles and responsibilities.

Appropriate performance and results indicators are still lacking

5.43 In 2000 we noted that the Department had not implemented appropriate performance and results indicators. We believed that in the absence of meaningful indicators and data, the Department was not in a position to assess and report on the performance and results of the education funds voted by Parliament. This situation also made it difficult for the Department and First Nations to make informed decisions about future priorities and directions.

5.44 The Department agreed with our observations and reviewed the feasibility of adapting elements of the Education Indicators Set developed by the Council of Ministers of Education, Canada and of the Pan-Canadian Education Indicators used by Statistics Canada. The aim was to establish a framework that would be comparable with other education reporting in Canada. In 2002 a departmental analysis concluded that, although several of these indicators could be used to measure and report on education on reserves, many data currently collected from First Nations would need to be modified or expanded to ensure comparability of information. For example, there are currently limited data on the education performance of students attending school on reserves.

5.45 The Department has informed us that it intends to work with First Nations to revise its reporting requirements, improve the reporting of program information, and increase the analysis of available data. The Department is developing a profile of all the education data it collects. The intent is to ensure that data collection strikes a balance between the need for good data and performance measurement and the need to minimize the reporting burden on First Nations. Pilot projects are also underway in some regions.

5.46 **Recommendation**. Indian and Northern Affairs Canada, in consultation with First Nations, should accelerate its efforts to develop and apply appropriate performance and results indicators along with targets.

Department's response. Indian and Northern Affairs Canada has undertaken a data collection review that will provide a profile of all education data it currently collects, including the rationale and authority. This work will contribute to the Department's Managing for Results Initiative. This accountability regime will focus on clear roles and responsibilities, clear performance expectations, balanced expectations and capacities, credible reporting, and reasonable review and adjustment. The Department will also participate in the Aboriginal roundtable on accounting for results led by the Treasury Board Secretariat and in the development of key indicators to be used in the Aboriginal Report Card.

5.47 Our 2000 audit also identified a number of opportunities for operational improvements. We focussed on information related to the costs of education services, on tuition and funding agreements, and on school evaluations.

The Department still does not have good cost information

5.48 In 2000 we found that the Department did not know the actual education costs; nor did it have a cost comparison of the different delivery mechanisms used. We recommended that the Department develop and apply uniform cost criteria to compare education costs and results among the different delivery approaches.

5.49 The Department carried out or funded additional studies to compare the funding it provides to First Nations with what provinces provide to their school boards. The Department did not endorse the results of these studies, and no changes have been made.

5.50 The lack of reliable and consistent information on education costs limits the Department's ability to manage the education programs effectively. For example, the funding formula for band-operated schools has not been modified since its inception in the late 1980s. First Nations have argued for years that funding levels are insufficient, notably to pay teachers at a salary level comparable with that of their provincial counterparts. The Department considers the capacity of First Nations to engage and retain the necessary teaching staff a significant factor in offering comparable education. It has undertaken a study comparing the salary of teachers in First Nations schools with that of provincial teachers. At present, the Department does not know whether the funding provided to First Nations is sufficient to meet the education standards it has set and whether the results achieved, overall and by the different delivery mechanisms, are in line with the resources provided.

5.51 **Recommendation.** Indian and Northern Affairs Canada should undertake to obtain reliable and consistent information on the actual costs of delivering education services on reserves and compare the costs with those of providing comparable education services in the provinces.

Department's response. Indian and Northern Affairs Canada has undertaken a review to compare the funds it allocates to schools operated by First Nations with the funds those schools would receive under the applicable provincial funding formula. As well, a comparative study of the salaries of teachers in First Nations schools and those in provincial schools is underway.

Issues concerning tuition agreements persist

5.52 In 2000 we identified a number of issues related to tuition agreements between First Nations and provincial school boards and between the Department and provincial school boards. The Department accepted our recommendation to address these issues.

5.53 We noted progress in one region where tuition agreements are in place and are generally kept up to date. In other regions, many agreements were still not in place, were in dispute, or had expired. In some instances, officials believe that First Nations do not have the capacity to negotiate the agreements effectively. Nor is it clear that adequate support is available to help First Nations with this task. In our view, the Department needs to ensure that tuition agreements are in place, so that provincial schools provide for the education needs of First Nations students and that the responsibilities of all parties are clearly laid out.

5.54 It is also important that the Department play a more active role in ensuring that these tuition agreements are adhered to and that it fulfill its own responsibilities. In one community we visited, officials told us that three First Nations students enrolled in a provincial school had been expelled from the school for three consecutive years before band and departmental officials became aware of the situation. Under the tuition agreement between the First Nation, the school board, and the Department, the school board has a clear obligation to notify the band council and the parents before taking disciplinary action against a student. The Department also reaffirmed that, notwithstanding any clause in the agreement, the Minister maintained his responsibility for the education of Indian students. However, we saw no documentation in the departmental files indicating what action, if any, the Department had taken when it became aware of the students being expelled.

5.55 **Recommendation**. Indian and Northern Affairs Canada, in consultation with First Nations, should ensure that tuition agreements are in place. The Department should also provide its regional offices with sufficient guidance and training to ensure that its responsibilities are understood and applied consistently.

Department's response. Indian and Northern Affairs Canada agrees that tuition agreements should be in place. The creation of the Regional Operations Support and Services Sector will help ensure that the necessary tuition agreements are in place across the regions.

School evaluations need to be completed

5.56 In 2000 we reported that a significant number of school evaluations needed to be completed. We also observed that some of the completed evaluations disclosed serious deficiencies in school operations but no systematic mechanism existed to ensure that the deficiencies were addressed. The Department agreed with our recommendation that these evaluations should be completed and recommendations implemented within a reasonable time.

5.57 We found that some regions have made efforts to complete more school evaluations, but some remain outstanding. The Department does not know how many evaluations have been done or need to be done because it does not track this information. In addition, the intended use of completed evaluations in the Department is still not clear. We noted that one region does not even receive copies of the evaluations and another had difficulty locating the most recent evaluations completed. In two regions, officials told us that they do not always have the time or the skills to deal with evaluation findings.

5.58 The national program guidelines issued by the Department for 2004–05 stipulate that an independent evaluation of each band-operated and federal school is to be undertaken every five years. Each evaluation must include, at a minimum, a review of curriculum, an assessment of instructional quality and standards, and a review to determine if community and school objectives have been achieved. Under these guidelines, each First Nation is responsible for implementing the recommendations. The Department's approach to dealing with the findings and recommendations contained in these evaluations is not consistent.

5.59 **Recommendation**. Indian and Northern Affairs Canada, in co-operation with First Nations, should ensure that school evaluations are completed and that recommendations are addressed within a reasonable time.

Department's response. Indian and Northern Affairs Canada agrees that school evaluations should be completed and has provided direction for this activity in the national program guidelines that took effect in September 2004. The creation of the Regional Operations Support and Services Sector will help ensure that First Nations receive the appropriate support in conducting evaluations and following up on their recommendations.

Post-Secondary Student Support Program

The policy and the program objective are under review

5.60 The Department has a clear policy and objective in place for the Post-Secondary Student Support Program. The policy is to encourage Registered Indians and Inuit to acquire university and professional qualifications. The objective of the program is to help Registered Indians and Inuit students to attend and succeed in recognized post-secondary education programs, thereby improving their chances of finding work. Both the policy and the objective have generally remained the same in recent years.

5.61 In September 2001, the Department informed the government that a comprehensive review of the policy was ongoing. It committed to developing recommendations, in consultation with First Nations, to update the policy framework and program delivery approach by 2003. According to officials, the purpose of the review is twofold: to update the program to better align it with the current situation of post-secondary education in Canada, and to address concerns related to equity, transparency, and access to the program. At the end of our audit, the Department and First Nations were working on the review.

Management and accountability framework is deficient

5.62 We expected that the Department would have systems and practices, including a sound management and accountability framework, which would enable it to implement the program in a way that reflects the approved policy and objective. Overall, we found that the framework is deficient.

5.63 A few years after the start of the program, the government adopted a policy of devolution whereby detailed administration of funding was transferred to First Nations. In 1989 the Department put in place a new management and accountability framework that applied to a number of programs, including the Post-Secondary Student Support Program. Under the framework, the Department would transfer, on a program-by-program basis, a fixed sum of money to First Nations. Once the minimum requirements of each program were met, First Nations would be allowed to reallocate funds among programs according to their priorities. The Department considered that this new approach would emphasize achieving defined results or program outputs for a given level of funding. First Nations would report information to the Department on how they had used the money and for what results. For its part, the Department would continue to set policy and monitor and evaluate the programs. The Minister would remain accountable for the performance of the various programs.

5.64 The Department also modified the implementation of the Post-Secondary Student Support Program to reflect the framework described above and respond to concerns about the unpredictable and rapid growth of program expenditures. It indicated to First Nations that the changes were intended to give them more flexibility in administering the program and more control over how they used program funds. These changes significantly affected the implementation of the program and the accountability between the parties involved—including the Department, the central agencies, and First Nations students and communities. With few exceptions, the Department no longer provides financial assistance to individual post-secondary students under the program. Instead, it transfers funds to First Nations to support post-secondary education for their people. The funding arrangements between the Department and First Nations define the amount of money and how it should be used.

5.65 In examining program implementation and accountability under the new framework, we found significant weaknesses in a number of key areas. These included ambiguity in the Department's roles and responsibilities, potential inequities in how funds are allocated, a lack of clearly defined expected results, limited program and performance information, and discrepancies in the information provided to the Treasury Board.

5.66 In our opinion, these weaknesses seriously undermine the capacity of the Department and First Nations to work together toward achieving the program's objective, using resources effectively to produce expected results, measuring and reporting performance, and taking corrective action when necessary.

Roles and responsibilities for delivering the program are unclear

5.67 We expected the Department to have clearly defined and documented its roles and responsibilities. This was not the case.

5.68 As noted earlier, the Department's management and accountability framework transferred control of the detailed administration of funds to First Nations. In transferring control of the funds, the Department requires First Nations to administer the program by applying the departmental eligibility requirements and to establish an appeal process for their administrative decisions on students' eligibility to receive funding and on the amount of that funding. The Department also provides First Nations with flexibility to define and use their own administrative procedures and allowance schedules.

5.69 We found considerable uncertainty in the Department on the interpretation of the nature and extent of First Nations' flexibility in managing the program. Some officials told us that the Department has only a funding role and that First Nations have complete freedom in determining who is eligible to receive funding and the amount of that funding. Others believe that there are minimum program requirements that First Nations must meet, such as ensuring that post-secondary institutions or programs of study are eligible under the program and that funding to each student is within the limits set in the program. The Department developed a list of eligible institutions in the late 1980s. The list has not been updated since then and its use is not clear. However, beginning in September 2004, the maximum living allowance must reflect the living allowances established by the Canada Student Loan Program.

5.70 The Department's activities to monitor program compliance in recent years have been limited. Although the Department issued guidelines in 1998 to monitor compliance, it has not fully implemented them. As a result, it does not have assurance that program requirements are implemented.

5.71 In the regions we visited, some officials consider that monitoring for compliance is not meaningful. The program does not tie funding to the number of eligible students to be supported, and officials believe that First Nations can establish their own program priorities and reallocate funds. In our view, unless the Department is clear about its roles and responsibilities, and those of First Nations, it cannot put in place systems and practices to obtain assurance that program requirements are implemented as defined when transferring funds to First Nations.

The allocation of funds does not ensure equitable access to the program

5.72 We expected the Department to have a mechanism for allocating funds to ensure equitable access to as many students as possible. Under the program's current practices, the Department allocates a fixed amount of money to the regions; in turn, they allocate funds to First Nations to provide post-secondary financial assistance to students. The amounts allocated are generally based on historical funding levels, without reference to the actual number of eligible students in a particular region or First Nation. As a result, some First Nations may be receiving more funds than they need under the program, and some not enough.

5.73 Our review of a sample of First Nations' financial statements in three regions confirmed that program surpluses and deficits do exist. Departmental officials told us that these surplus and deficit situations do not need to be monitored because they would not trigger any change to First Nations' funding levels for this program. With the flexibility allowed, First Nations with a surplus of funds from the program can transfer the money to other programs. Those First Nations with insufficient funds can transfer money from other programs to top up the amount available for providing financial assistance. They can also deny funding to eligible students or use a combination of the two options.

5.74 Currently, the Department does not know whether the funds earmarked for the program are sufficient to support the post-secondary education of all eligible students. In 2000 the Assembly of First Nations stated that the lack of federal funding was preventing about 9,500 First Nations people from pursuing post-secondary education. We noted that the Department does not track the number of unfunded eligible students.

5.75 We are concerned that the current funding methodology neither ensures that eligible students have equal access to the program nor maximizes the number of students receiving assistance. We are also concerned that when a First Nation has a surplus and decides to move post-secondary program funds to other programs, there is no assurance that it has first met the needs of all eligible students. Ultimately, it is not clear whether the allocation mechanism in place, combined with the flexibility to reallocate funds, is consistent with the program policy and objective.

The Department needs better information

5.76 Given the objective of the program and ministerial accountability for its performance, we expected that the Department would have sound information on the program and that it would use this information for monitoring and decision-making purposes.

5.77 Currently, the Department receives global information from First Nations on the total number of people assisted at one point in the year and the annual number of graduates. It also receives audited summary-level financial statements for each First Nation and basic unaudited information on individual students and their study programs.

5.78 We found that the Department does not fully use the information it receives from First Nations to monitor program implementation. For example, it does not compare program spending with the number of students assisted to assess whether the two correspond. Nor does it use the information on students and study programs to obtain assurance that only eligible students taking eligible courses are receiving funding. We also noted that the Department does not collect information on how much financial assistance individual students are receiving and how many eligible students are not being funded.

5.79 Due to the lack of information and of analyses of the information available, the Department does not know how First Nations ultimately spend the money earmarked for post-secondary education. This also prevents the Department from taking corrective action when warranted.

5.80 Given that the Minister is accountable for the program, we expected that the Department would have adequate mechanisms to measure program performance. This was not the case.

5.81 The main indicator that the Department uses to measure performance is the annual number of students receiving support under the program. In our opinion, this indicator is deficient. It is not useful for determining how many, or what proportion, of First Nations students in the program have successfully completed their studies and at what cost.

5.82 In our view, a definition of expected outputs, results, and performance is needed to measure performance. The Department and First Nations also need to agree on a precise definition of who is eligible to access the program and what level of financial support they should receive. None of these have been clearly defined and documented.

Discrepancies in the information provided to the Treasury Board

5.83 In September 2001 and in July 2003, the Department obtained approval from the Treasury Board for renewed authorities governing the program. These authorities govern how the program should be implemented and how its funds should be managed.

5.84 We found discrepancies between the information that the Department provided to the Board about the management of the program and the way the program is actually being delivered. For example, the Department told the Board that it had procedures to minimize the risk that the funds earmarked for post-secondary education would not be used for that purpose. However, as indicated earlier, the Department does not track how the program funds are spent and permits First Nations to move funds from the program to other programs. Therefore, the Department has no assurance that program funds are used only for the purpose intended, as it had led the Treasury Board to believe.

5.85 We also found that the Department did not implement the new program authorities, as approved by the Treasury Board in a timely manner. These authorities, among other things, set student funding limits to reflect the Canada Student Loan Program. The Department did not incorporate these new authorities into its annual funding agreements with First Nations until 2004–05. As a result, for two years the Treasury Board's approval of renewed authorities had no impact on how the Department and First Nations implemented the program.

5.86 At the end of the audit, the Department informed us that national program guidelines have been developed based on the terms and conditions approved by the Treasury Board. These guidelines are included in the 2004–05 annual funding agreements with First Nations and will apply starting in September 2004. The terms and conditions expire in March 2005.

Toward stronger accountability

5.87 In 2002, in a study on accountability, we defined accountability as a relationship based on the obligations to demonstrate, review, and take responsibility for performance, both the results achieved in light of agreed expectations and the means used. We also suggested five principles that define effective accountability: clear roles and responsibilities, clear performance expectations, balanced expectations and capacities, credible reporting, and reasonable review and adjustment. Exhibit 5.3 summarizes these principles. We believe that they could help guide the work of the Department and First Nations in their current review of this program.

Exhibit 5.3 Five principles of effective accountability

❶ **Clear roles and responsibilities.** Roles and responsibilities should be well understood and agreed on by the parties.

❷ **Clear performance expectations.** The objectives, the expected accomplishments, and the constraints, such as resources, should be explicit, understood, and agreed on.

❸ **Balanced expectations and capacities.** Performance expectations should be linked to and balanced with each party's capacity to deliver.

❹ **Credible reporting.** Credible and timely information should be reported to demonstrate what has been achieved, whether the means used were appropriate, and what has been learned.

❺ **Reasonable review and adjustment.** Fair and informed review and feedback on performance should be carried out by the parties, achievements and difficulties recognized, appropriate corrective action taken, and appropriate consequences carried out.

5.88 **Recommendation.** Indian and Northern Affairs Canada, in consultation with First Nations, should develop and implement a strong and meaningful accountability regime for its Post-Secondary Student Support Program. This regime should include the following principles of effective accountability: clear roles and responsibilities, clear performance expectations, balanced expectations and capacities, credible reporting, and reasonable review and adjustment.

Department's response. Indian and Northern Affairs Canada and First Nations are jointly working on a comprehensive review of the post-secondary education programs, including the Post-Secondary Student Support Program. Principles of effective accountability will be addressed as a key component of this review.

5.89 **Recommendation.** Indian and Northern Affairs Canada should ensure that it provides accurate information to the Treasury Board about the way in which the Post-Secondary Support Program operates.

Department's response. Indian and Northern Affairs Canada is committed to providing full and accurate information to the Treasury Board and will continue to do so.

Parliament is not receiving a complete picture

5.90 The Department's reporting to Parliament on the program's costs, results, and performance does not provide a complete picture of the program and what is actually being achieved with departmental funds. Our review of the Department's Estimates documents for the past five years indicates, for example, that the Department does not provide specific targets or timelines that would allow parliamentarians to judge the performance of the program.

Exhibit 5.4 summarizes our assessment of the completeness of the post-secondary education information that the Department has reported to Parliament.

5.91 We noted that the Department's reporting to Parliament does not clearly present the program's objective. The Department presents "improving education" as a way of increasing community self-sufficiency, without explaining what this means or how it is measured. It does not compare the post-secondary education achievement of First Nations people, living on or off reserves, with that of the Canadian population as a whole; nor does it explain to what extent the program contributes to the educational achievement of First Nations.

5.92 In reporting results to Parliament, the Department has consistently used the total number of students receiving support under the program as its main performance indicator. For example, the Department asserts that the program was successful in 2002–03 as about 25,000 First Nations people were supported under it that year, while only 250 people were supported in 1968–69. In our view, this information does not tell the whole story. Unaudited departmental information also indicates that the annual number of students being funded has actually been declining in recent years, from a high of about 27,000 in 1998–99 to about 25,000 in 2002–03. However, the Department does not explain this trend.

5.93 We used data from the 2001 census to compare the post-secondary educational achievement of First Nations people and the Canadian population as a whole. We noted that about 27 percent of the First Nations population (North American Indian) between 15 and 44 years of age hold a post-secondary certificate, diploma, or degree, compared with 46 percent of the Canadian population within the same age group. We believe that Parliament should be informed about the gap, its potential causes, and the way that the program helps to address it. Parliament should also be informed about the targets established for the program and the progress made.

5.94 **Recommendation.** Indian and Northern Affairs Canada should improve the quality of the performance information that it reports to Parliament. It should clearly define and document the objective and expected results of the Post-Secondary Student Support Program, report on costs and performance, and clarify how the program is making a difference in narrowing the gap in post-secondary education between First Nations and the Canadian population as a whole.

Department's response. Indian and Northern Affairs Canada is committed to providing relevant performance information to Parliament. This issue will be addressed as part of the review of post-secondary education programs currently underway.

Exhibit 5.4 Our assessment of the post-secondary information reported to Parliament

Activities	Current reporting in performance reports	Suggested reporting for performance reports
Organizational context and strategic outcomes are clear	Education is part of overall socio-economic outcomes of "increased self-sufficiency." There is no separate discussion of post-secondary education and of the student support program. Roles of First Nations and other partners are not mentioned in the context of this program.	Explain how the Post-Secondary Student Support Program contributes to addressing the gap in post-secondary education and benefits individuals and communities. Explain the roles of partners, namely First Nations, and their contribution to results achieved.
Performance expectations are clear and concrete	No clear relationship exists between "improved education" and the single indicator used: the annual number of students being funded. There is no mention that up to 12 percent of the post-secondary budget can be used to support study programs or institutions rather than students. There is no objective or specific targets and timelines. There is no description of the strategies to achieve performance expectations.	Inform Parliament about program objectives and targets and time frame to reach targets. Explain the support to study programs and First Nations post-secondary institutions. Provide explanations on the environment in which these objectives are to be achieved.
Key results are reported against expectations	The reporting does not allow assessment of whether the Department is failing or succeeding with this program, as there are no performance expectations. The annual number of funded students does not capture what portion of the program demand or potential clients is addressed. There are no indications that students may be denied funding. There is no mention that "expenditures" are budgeted figures instead of actual spending, as First Nations can reallocate funds between programs, and that 12 percent of the budget can go to support study programs rather than students. The only discussion of risk is related to rising tuition costs. No risk analysis of meeting performance targets is provided because no targets have been set.	Provide concrete targets in proper context. Provide other indicators of outcomes—for example, the proportion of eligible students of an appropriate age group attending post-secondary institutions, and the proportion of these students supported by the program. Comparison with non-First Nations people could also be provided. Provide a more accurate number of the amount allocated to the program. Provide a brief risk analysis.
Performance information is credible and balanced	Since 2001–02, the Department has stated that its data are 99 percent reliable. There is no mention of significant data limitations for this program, such as the annual number of funded students is based on a snapshot of people funded at a single date, and students dropping out shortly before or after that date are not captured. Data are provided by various First Nations and organizations and are not verified.	Provide more information on the limitations of post-secondary data.
Use of performance information is demonstrated	There are no indications that the Department uses results information to manage and improve the program. For example, no actions or explanations are reported about the declining number of First Nations students being funded.	Discuss how results information is used—for example, to maximize the number of eligible students accessing the program.

Source: Indian and Northern Affairs Canada's performance reports from 1998–99 to 2002–03; April 2002 Report of the Auditor General, Chapter 6, A Model for Rating Departmental Performance Reports

Conclusion

5.95 **Elementary and secondary education.** Despite more studies and several new initiatives, Indian and Northern Affairs Canada made limited progress in addressing most of the issues and recommendations raised in our April 2000 Report, as well as those raised in the June 2000 Report of the Public Accounts Committee. The Department does not know whether funding levels provided to First Nations are sufficient to meet the education standards it has set and whether the results achieved are in line with the resources provided.

5.96 We are concerned about the lack of progress because a large education gap remains between First Nations people living on reserves and the Canadian population as a whole. In addition, the time estimated to close this gap has increased slightly, from about 27 to 28 years.

5.97 We believe that, in consultation with First Nations and other parties, the Department needs to urgently define its roles and responsibilities and address the long-standing issues affecting First Nations elementary and secondary education. It also needs to improve its operational performance and reporting of results.

5.98 **Post-Secondary Student Support Program.** The number of First Nations people having a post-secondary certificate, diploma, or degree continues to grow. A policy and a program objective are in place for the Post-Secondary Student Support Program and both are being reviewed. However, significant weaknesses exist in the Department's management and accountability framework for the program. The Department has not clearly defined and documented its roles and responsibilities, the way that it allocates funds to First Nations does not ensure equitable access to as many students as possible, and it does not know whether the funds allocated have been used for the purpose intended. Moreover, the information available on the performance of the program is inadequate. As a result, the Department does not know whether program funds are sufficient to support all eligible students, and it has no assurance that only eligible students taking eligible courses are receiving funding.

5.99 We also found discrepancies in the information that the Department provided to the Treasury Board about the way the program operates. In addition, the Department's reporting to Parliament does not present a complete picture of the program. For example, it does not explain why the number of students receiving support has been declining over the last several years; nor does it provide information on how effective the program has been in narrowing the gap in post-secondary education between First Nations and Canada as a whole. As the program has evolved, the roles and responsibilities of the Department and First Nations have changed. In our view, both parties need to work co-operatively to develop and implement a strong accountability regime for the program.

5.100 **Co-operative efforts are needed.** We continue to believe that success in providing elementary and secondary education to First Nations students can be achieved only if their needs and aspirations are appropriately identified and served by an education system that is designed to fulfil them. In our view, all stakeholders, including the Department, First Nations, provinces, school boards, parents of school-age children, and the students, need to work together toward a common goal of progress.

5.101 The education policy review underway and the periodic renewal of authorities for program delivery are positive steps. They provide the Department, central agencies, First Nations, and other partners with an opportunity to take a fresh look at the education programs' design, administration, and accountability for and reporting of results, with the aim of closing the education gap.

Department's overall response. First Nations education is one of the highest priorities of Indian and Northern Affairs Canada. The gains in education have accounted for the single biggest contribution to the closing of the gap in the Human Development Index between Aboriginal Canadians and Canadian society as a whole. The Department recognizes the importance of the issues raised in this chapter and reiterates its commitment to working with First Nations and other stakeholders to improve educational outcomes for First Nations students.

Investments over the last 30 years in elementary, secondary, and post-secondary education have made a real, tangible impact on the total level of First Nations educational attainment. While the Department is committed to moving forward with First Nations and other partners as quickly as possible, given the complexity of issues such as jurisdiction, geography, and demography (as outlined in Appendix A of this chapter), it is clear that success in First Nations education must be measured over the longer term.

Nearly all of the Department's education programs are delivered either directly by or in consultation with First Nations. Since devolution of program delivery to First Nations also assumes devolution of some accountability for management and results, Indian and Northern Affairs Canada acknowledges the need for the Department, First Nations, and other partners to clarify their respective roles and responsibilities within a context of shared accountability.

The follow-up work to the April 2004 Canada—Aboriginal Peoples Roundtable may help to guide the Department's work in support of improved First Nations educational outcomes in the broader context of Aboriginal lifelong learning. This more holistic and co-ordinated approach to learning will serve as the framework within which the Department, with its First Nations partners, can set a clear course for the future in support of First Nations control of First Nations education.

About the Audit

Objectives

Follow-up. The objective of the follow-up audit was to assess the extent to which Indian and Northern Affairs Canada has acted on recommendations made in Chapter 4 of our April 2000 Report and in the June 2000 Report of the Public Accounts Committee. Specifically, we assessed the extent of improvement in the following areas of elementary and secondary education:

- resolving long-standing issues and addressing the education gap,
- defining and documenting roles and responsibilities,
- developing and using performance indicators, and
- improving operational performance.

Post-Secondary Student Support Program. Our audit objectives for the Post-Secondary Student Support Program were to determine whether a clear policy and objective are in place within the Department, systems and procedures to support program implementation are consistent with the policy and objective, and relevant information is reported to Parliament.

Scope and approach

Indian and Northern Affairs Canada is the main federal organization responsible for administering elementary and secondary education for First Nations students living on reserves, and for supporting First Nations and Inuit post-secondary education.

Follow-up. Our examination focussed on the Department's progress in addressing the issues raised and recommendations made by our Office and by the Public Accounts Committee. It also included a review of progress on implementing the Mi'kmaq Education Agreement.

Post-Secondary Student Support Program. The audit focussed on the activities and results related to the Post-Secondary Student Support Program, the major component of the Department's post-secondary education program. We reviewed policy developments and analyzed information since the beginning of the program in 1977.

The audit team carried out interviews with departmental managers and staff and reviewed relevant documents at the Department's headquarters and in four regions (Atlantic, Ontario, Alberta, and British Columbia). We also reviewed the elementary, secondary, and post-secondary education files of 20 First Nations in the latter three regions. Although we did not audit the activities carried out by First Nations and their organizations, we did seek their views on education matters. The team also visited eight First Nations communities. The community visits involved discussions with political leaders, education managers, and school principals and teachers, as well as general observation of education facilities. We also sought the views of national and regional First Nations organizations, including the Assembly of First Nations, the First Nations Education Steering Committee, Treaty Six Education, and the Mi'kmaw Kina'matnewey, and we reviewed the documentation provided by them.

Criteria

Follow-up. Our follow-up audit was based on the following overall criterion: The Department should have made reasonable progress in addressing the issues and recommendations made in our April 2000 Report and in the June 2000 Report of the Public Accounts Committee with respect to First Nations elementary and secondary education.

Post-Secondary Student Support Program. Our audit was based on the following criteria:

- The Department has a clear policy and objective for the Post-Secondary Student Support Program.

- Systems and procedures in place to support program implementation are consistent with the approved policy and objective.
- The Department reports relevant information to Parliament about program costs, performance, and results relative to the program objective.

Related audit work

April 2000 Report of the Auditor General, Chapter 4, Indian and Northern Affairs Canada—Elementary and Secondary Education

December 2002 Report, Chapter 9, Modernizing Accountability in the Public Sector

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Appendix A Issues and challenges in First Nations education

Jurisdiction

First Nations people living on reserves receive education funding directly from the federal government, but are required to follow standards from the provincial government, for teachers and curriculum. According to Indian and Northern Affairs Canada, jurisdictional issues create uncertainty, instability, and confusion in terms of program delivery. For example, it is unclear who is responsible for funding the education of First Nations children whose parents have temporarily moved off a reserve to attend a post-secondary institution and have brought their children with them. The Assembly of First Nations believes that education is an inherent and treaty right that must be under the full jurisdiction of First Nations.

Geography and demography

In 2003, about 75,700 First Nations people were living on reserves located in special access areas and 16,500 were living in remote regions. In addition, First Nations communities tend to be small; most have fewer than 500 residents. As a result, schools in many communities tend to be small, do not benefit from economies of scale, and have difficulty providing a range of educational services.

Parental involvement

Parenting skills are considered among the strongest predictors of early educational success. Many First Nations parents are unprepared for their roles and face significant challenges in the early years of their children's education. In addition, many parents who were educated in the 1960s, 1970s, and 1980s have negative perceptions of formal education. There is also a higher incidence of single-parent families on reserves (32 percent) than in the rest of Canada (17 percent).

Health problems

Serious health problems exist on many reserves, including fetal alcohol syndrome, diabetes, tuberculosis, and HIV/AIDS. Some communities also lack basic services and amenities such as adequate housing and running water. These problems can lead to lower attendance rates and increased special education needs.

Economic conditions

The average unemployment rate on reserves is significantly higher than the Canadian average. Poor economic conditions on reserves can be viewed as both a cause and an effect of lower educational outcomes. If economic opportunities following graduation are limited, the motivation of students to complete their education may be affected. At the same time, if fewer students graduate and enter the workforce, the existing economic situation may not improve.

Racism

The Royal Commission on Aboriginal People and the report of the Minister's working group on education both noted that racism continues to be an obstacle for many First Nations students, especially those attending schools located off reserves. According to the working group, low expectations for First Nations students from their teachers are probably the most pervasive form of racism in education.

Teacher recruitment and retention

Many First Nations have difficulty attracting and retaining qualified teachers. The causes are attributed to the difficulties in paying them a competitive salary; a lack of housing and other private and public services, especially in remote locations; and a lack of professional training and systemic support.

Source: Indian and Northern Affairs Canada and other publications; discussions with departmental officials and First Nations representatives (unaudited)

Appendix B Key events since the start of assistance to First Nations post-secondary students

1977 Assistance to post-secondary students was formalized for the first time with a program to encourage registered Canadian Indians and Inuit to acquire university and professional qualifications. In 1977–78, $9 million was provided to support 3,500 students. Funds were paid directly to post-secondary institutions (tuition fees) and to eligible students (living allowances).

1983 The Department introduced the University and College Entrance Preparation Program to recognize mature students and others who did not have secondary school education. Bill C-31, which reinstated people who had lost their Indian status, contributed to an increase in the number of First Nations student enrolments.

1988 First Nations and government engaged in major reviews of the initial program. The Auditor General of Canada reported that the program did not clearly define management roles and responsibilities, maintain program consistency, or provide adequate management information with which to measure program effectiveness.

1989 The Department was funding 15,000 students and providing $130 million in fundings. Concern about the unpredictable and rapid growth of program expenditures prompted the Department to introduce a revised program, the Post-Secondary Student Support Program, on 20 March 1989. New rules were introduced. For example, funding would no longer be based on demand but on a fixed budget. If the number of eligible applicants were to exceed the budget, applications would be deferred. Program administration was transferred to First Nations and their organizations, and flexibility to modify program rules was confirmed.

1991 The government approved incremental funding of $320 million for the program for 1991–92 to 1995–96. In 1991–92, $193 million was provided to support 21,440 students.

1992 In 1992–93, the Department completed a strategic review of the program and found that resources were not being provided to meet all First Nations needs. It recommended that a system of block budgeting be used to enable First Nations to set their own student support priorities, control resources in their allocated budget, and optimize the use of educational and training funds from other sources.

1992 Funding for the program became part of block-funding multi-year arrangements with First Nations. This program was completed in 1997.

1994 The number of students funded under the program in 1993–1994 grew to 23,000. An additional $20.3 million was provided in 1994–95, and $20.0 million for each of the years 1995–96 to 1998–99. This increased the total program funding to $247.3 million for 1994–95 and $262.3 million for the remaining four years.

1997 Block-funding envelopes were capped with annual increases to be allotted according to Treasury Board directives.

2001 The Treasury Board approved renewed authorities for the program. One of the most notable changes was that maximum living allowances were to be tied to the Canada Student Loan Program. The Department intended to complete, in co-operation with First Nations, a review of the program by 2003.

2003 The Treasury Board approved an extension of the authorities until 31 March 2005, with slight revisions. The Department intends to implement these authorities in 2004–05.

Source: Departmental and non-departmental documents; discussions with departmental officials and First Nations representatives (unaudited)

Report of the Auditor General of Canada to the House of Commons—November 2004

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2004

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to the House of Commons

NOVEMBER

Chapter 6
Canada Revenue Agency—Resolving Disputes and Encouraging Voluntary Disclosures

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

6

Canada Revenue Agency

Resolving Disputes and Encouraging Voluntary Disclosures

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Canada Revenue Agency
Resolving Disputes and Encouraging Voluntary Disclosures

Main Points

6.1 A key activity of the Canada Revenue Agency's Appeals Branch is resolving objections to income tax and GST assessments as well as appeals of Canada Pension Plan (CPP) and Employment Insurance (EI) rulings and assessments. We found that the Branch is resolving most of the income tax and GST objections it receives, and it is doing this in a way that is fair and impartial. As well, over half of the objections are resolved within the timeliness goals that the Agency has set. However, taxpayers can appeal their case to the Tax Court of Canada if they have not received a decision from the Appeals Branch after 90 days. Many of the Branch's timeliness goals for income tax objections exceed 90 days by a large margin.

6.2 The Branch is resolving CPP and EI appeals impartially but has difficulty resolving them in a timely way. The Agency needs to consider a more efficient overall process for dealing with CPP and EI rulings, which are issued by the Revenue Collections Branch, and any related appeals of those rulings, which are dealt with by the Appeals Branch.

6.3 The Appeals Branch also administers the Agency's Voluntary Disclosures Program. The program has encouraged taxpayers and GST registrants to correct past errors or omissions. However, we found that the program is not administered consistently across the country. Further, we are concerned that the Agency has gone beyond what Parliament was told the legislation supporting the program would be used for.

Background and other observations

6.4 Taxpayers and GST (or HST) registrants who disagree with assessments by the Canada Revenue Agency on income tax, GST, and excise tax matters can file an objection with the Agency. Affected parties who disagree with the Agency's rulings and assessments on Canada Pension Plan and Employment Insurance can appeal. These objections and appeals are reviewed by the Agency's Appeals Branch. In 2003–04, appeals officers adjusted about 62 percent of the income tax and GST assessments they reviewed.

6.5 The Voluntary Disclosures Program allows taxpayers and GST registrants to correct inaccurate or incomplete information previously reported to the Agency, or to disclose information not previously reported, without penalty or prosecution and sometimes with reduced interest. Its goal is to promote compliance with the tax laws. The Agency needs to analyze the program's results to ensure that this goal is being met.

The Agency has responded. The Canada Revenue Agency agrees with all of our recommendations. In its responses, it describes actions it will take to address the recommendations.

The Agency disagrees with our concern that it has gone beyond what Parliament was told the legislation supporting the Voluntary Disclosures Program would be used for. The Agency believes that the intent of Parliament is contained in the words of the acts passed by Parliament.

Introduction

HST—Harmonized sales tax, a combined tax in which the goods and services tax (GST) is added to the provincial sales tax in the provinces of New Brunswick, Nova Scotia, and Newfoundland and Labrador, and collected by business owners

Excise tax—A tax imposed on certain goods such as tobacco, wine, jewellery, and certain types of vehicles

6.6 Taxpayers and GST (or HST) registrants who disagree with assessments by the Canada Revenue Agency (CRA) on income tax, GST, and excise tax matters can file an objection with the Agency. Affected parties who disagree with the CRA's rulings and assessments on Canada Pension Plan and Employment Insurance (CPP and EI) can appeal. These objections and appeals are reviewed by the Agency's Appeals Branch; the Branch's mandate calls for it to conduct these reviews fairly and impartially. A taxpayer, registrant, or affected party who disagrees with the Branch's decision can appeal to the courts.

6.7 The Branch administers one of the government's largest administrative dispute resolution services. At March 2004, the Agency reported that almost $7.6 billion of income tax or GST assessments were in dispute.

6.8 The Branch had a budget in 2003–04 of about $80 million and some 1,200 full-time-equivalent staff. Objections and appeals are processed in Tax Services Offices and Tax Centres across the country. Headquarters staff provide policy direction and technical support and help resolve complex cases.

6.9 **Income tax, GST, and excise tax objections.** The income tax, GST, and excise tax objections process starts when a taxpayer or registrant files an objection with the Agency, setting out the background and reasons for the objection. In most cases, the taxpayer or registrant disagrees with an assessment issued by the Agency. The assessment usually originates in the Agency's Assessment and Client Services Branch or, in the case of an audit, in the Compliance Programs Branch. The disagreement may be with the facts of the case, the Agency's interpretation of how the laws apply to the facts, or both.

6.10 There are three possible outcomes to a valid income tax, GST, or excise tax objection. An appeals officer can recommend that the Chief of Appeals

- confirm the assessment, thereby rejecting the taxpayer's or registrant's arguments;
- allow the objection in full, thereby overturning the assessment; or
- confirm part of the assessment and overturn part of it (vary the assessment).

6.11 Taxpayers and registrants who disagree with the Branch's decision have the right to appeal to the Tax Court of Canada. If there is no such appeal of the decision, the issues in dispute are considered resolved, even where the taxpayer or registrant disagrees with the Branch's decision but is not willing to pursue the issue further.

6.12 **CPP and EI appeals.** CPP and EI appeals frequently deal with the issue of whether a worker is an employee or is self-employed. Only employees are subject to payroll deductions by their employers for CPP and EI. A worker, an employer, the Minister of Social Development (for CPP), or the Employment Insurance Commission (for EI) can ask the Agency's Revenue Collections Branch for a ruling on whether employment was pensionable (qualified for

CPP benefits) or insurable (qualified for EI benefits), what the earnings were, and how long the employment lasted. Any of those parties can appeal the ruling; the appeal will be reviewed by the Appeals Branch.

6.13 The Agency's auditors audit employers to determine whether they have deducted the correct amounts from their employees' pay for income tax, CPP contributions, and EI premiums. Employers have the right to appeal any assessment that results from an audit.

6.14 The Appeals Branch may confirm the original CPP/EI ruling or assessment, reject it, or vary it. An affected party who disagrees with the decision can appeal to the Tax Court of Canada.

6.15 **Voluntary Disclosures Program.** The Appeals Branch also administers the Voluntary Disclosures Program. The program allows taxpayers and registrants to correct inaccurate or incomplete information previously reported to the Agency, or to disclose information not previously reported, without penalty or prosecution and sometimes with reduced interest. Its goal is to promote compliance with the tax laws.

Focus of the audit

6.16 The Appeals Branch is responsible for resolving income tax, GST (or HST), and excise tax objections and CPP and EI appeals; for working with the Department of Justice Canada in preparing cases for litigation; for co-ordinating the income tax and GST fairness provisions that allow the Agency to waive or cancel all or part of any interest or penalty owed by a taxpayer or registrant; and for administering the Voluntary Disclosures Program. This audit covered income tax and GST (but not HST) objections, CPP and EI appeals, and the Voluntary Disclosures Program.

6.17 The objectives of the audit were to determine

- whether the Appeals Branch of the Canada Revenue Agency is resolving objections to income tax and GST assessments and appeals of CPP/EI rulings and assessments in a way that is fair, timely, and impartial; and
- whether the Voluntary Disclosures Program is encouraging compliance and protecting the tax base.

6.18 The Branch's work in the area of litigation was covered in our 1998 Report, Chapter 5, Interdepartmental Administration of the Income Tax System. The administration of the fairness provisions was covered in our 2002 Report, Chapter 2, Tax Administration: Write-Offs and Forgiveness. Further information about the objectives, scope, approach, and criteria for this audit can be found at the end of the chapter in **About the Audit.**

Observations and Recommendations

Income tax and GST objections

Most objections are resolved by the Appeals Branch

6.19 The Agency received about 73,200 income tax and GST objections in 2001–02, 69,900 in 2002–03, and 59,000 in 2003–04. The number of objections in 2001–02 and 2002–03 were unusual; many of them concerned how the interest portion of recent pay equity settlements was to be taxed. That issue is currently being adjudicated in the courts.

Pay equity settlements—Lump sum compensation payments given to certain employees based on gender discrimination that had occurred between 1982 and 1997

6.20 The annual number of objections resolved administratively by appeals officers has varied significantly, from 59,300 in 2001–02 to 64,600 in 2002–03, to 57,600 in 2003–04. Historically, over 93 percent of the decisions made by appeals officers are accepted by the taxpayer or registrant who objected. The other seven percent are appealed to the Tax Court of Canada or the Canadian International Trade Tribunal because the taxpayer or registrant disagrees with the decision and is willing to pursue the issue further.

6.21 Objections range from simple to complex; the majority are simple, as in these examples:

- A taxpayer is assessed because he failed to provide information requested by the CRA to support a deduction he made on a tax return; he objects to the assessment and provides the information.
- A taxpayer is assessed because she did not report interest income shown on a T5 information slip; she objects to the assessment, explaining that the T5 information was wrong.

Complex objections usually follow an assessment made as a result of an audit.

6.22 The breakdown of decisions on simple and complex objections in 2003–04 is shown in Exhibit 6.1. Simple objections represented 77 percent of the total number of objections and complex objections represented 23 percent. But those proportions are reversed when the dollar amounts in dispute are considered: simple objections account for about 25 percent of the total dollars in dispute and complex objections for about 75 percent.

6.23 We expected the Branch to keep track accurately of how the amounts in dispute were resolved, but we found that it has not done so. Without this information, the Branch does not know and cannot report how much of the taxes in dispute it confirmed or how much it returned to the taxpayers and registrants who objected to their assessments.

6.24 The Branch's objective is to resolve tax disputes. By their very nature, tax disputes involve money. Keeping track only of the number of objections filed and how they were resolved is not sufficient for management to understand the impact of the decisions made by appeals officers, nor the potential risks to the tax base triggered by objections from taxpayers and registrants. It is also essential that the dollar results of the Branch's decisions be recorded to a level of accuracy that permits good analysis and reporting. This may involve using estimates in low-risk cases.

Exhibit 6.1 Breakdown of decisions on simple and complex income tax and GST objections in 2003–04

Decision	Simple objections		Complex objections		Total objections	
	Number of decisions	Percentage of simple objections	Number of decisions	Percentage of complex objections	Number of decisions	Percentage of total objections
Assessment confirmed	14,158	38.3	3,748	34.1	17,906	37.3
Objection allowed in full	15,021	40.6	2,218	20.2	17,239	35.9
Assessment varied	7,810	21.1	5,026	45.7	12,836	26.8
Total	**36,989**	**100.0**	**10,992**	**100.0**	**47,981**	**100.0**

Source: Analysis of Canada Revenue Agency Appeals Branch database

6.25 **Impartiality.** Our interviews and file reviews indicate that appeals officers are impartial in reaching their decisions. The Branch's quality monitoring reviews have also found this to be the case. In examining the facts of an objection and the applicable laws, officers refer to the Agency's documentation supporting the assessment in question (which may include an auditor's report), together with representations made by the taxpayer or registrant. These representations often include new information that was not provided previously or was unavailable at the time of the audit. Appeals officers also review applicable legislation, court cases, and Agency policies, and they discuss the case with appropriate experts when necessary.

6.26 Appeals officers are expected to do more than check the accuracy of an audit. They are expected to try to resolve disputes administratively. If that is not possible, the taxpayer or registrant can appeal the decision to the Tax Court of Canada, which is a more expensive solution. There are many ways to resolve disputes administratively, from simply explaining the basis for an assessment, to reaching a common understanding of the facts involved and the applicable laws, to agreeing on a settlement.

6.27 While appeals officers must follow the law and the Agency's policies in deciding on an objection, they can agree to settle when appropriate. For example, an auditor disallowed a large portion of a taxpayer's automobile expenses because the taxpayer had not kept a travel log showing separately the distances travelled for business purposes and those travelled for personal purposes. The taxpayer objected to the assessment, claiming that the automobile was used mainly for business purposes. Through discussion and review of supporting documents, the taxpayer and the appeals officer were able to settle on a figure for expenses that was higher than the auditor had allowed but lower than the taxpayer had claimed. In some cases, reaching a settlement is fairly straightforward. In other cases it can be difficult, and the settlement may be completed by appeals officers at headquarters.

6.28 Most objections to an assessment are assigned to an appeals officer who is at the same job classification level as the assessor or auditor who issued the assessment. Classification levels generally reflect the competencies and experience required for a position, with higher levels requiring more competencies and experience. But the highest classification for auditors is AU6, whereas AU3 is the highest for appeals officers in the field (at headquarters it is AU4). Therefore, an appeals officer can be asked to resolve an objection to an assessment prepared by an auditor at a higher classification level. The more junior appeals officer could allow the objection and reject the auditor's assessment. This happens in practice, and it does not seem logical or appropriate, particularly in complicated cases where the issues are often highly technical and call for the judgment and experience needed to allow taxpayers and registrants to exercise their rights while protecting the public purse. At the time of our audit, the Branch was developing a human resources strategy to address issues such as the competencies and experience required for appeals officers.

6.29 **Alternative dispute resolution.** Mediation can be a useful technique when a consensus is possible and both sides see its benefits. For example, a taxpayer says an asset that has been sold has a fair market value of $100,000 for calculating the capital gain on the sale; the Agency's valuators say the fair market value is $150,000. If the parties are willing to settle, a mediator may find an acceptable resolution to the disagreement. The Agency has discussed using mediation for several years, but appeals officers and taxpayers have seldom used it.

6.30 **Feedback to auditors.** The offices we visited provide appeals decisions regularly to technical advisors in the Compliance Programs Branch. Appeals officers frequently change assessments issued by auditors from the Compliance Programs Branch that are the subject of a taxpayer's or registrant's objection. It is important that the auditors understand why the changes are made. It could be that the taxpayer or registrant gave the appeals officer information that was unavailable at the time of the audit, or the auditor made an error in applying the law to the facts. Technical advisors told us that they review the appeals decisions to identify common errors made by auditors and areas where training would help clarify the auditors' understanding of the law. They communicate this information to the auditors in team meetings and training sessions.

The Branch is working to improve timeliness

6.31 Over the last few years, the Agency has emphasized shortening the length of time it takes to resolve an objection. Timeliness goals set by the Branch were met in over half of the cases in 2003–04 for income tax and GST objections (Exhibit 6.2). The goals are based on historical averages and what the Branch considers a reasonable expectation, given the resources available and a desire to maintain quality.

6.32 Taxpayers have a legal right to appeal their case to the Tax Court of Canada if they have not received a decision from the Appeals Branch within 90 days of filing an objection. We found that many of the Branch's timeliness goals for income tax objections exceed 90 days by a large margin, and they include only the time that an appeals officer actually spends working on the

Exhibit 6.2 Over half of the timeliness goals for resolving income tax and GST objections were met in 2003–04

File	Timeliness goal (days)	Files that met goal (percentage)
Income tax		
Initial assessing	88	57.0
Post assessing	88	53.4
Assessing—other	112	64.8
Office audit	156	58.9
Tax avoidance	195	81.6
Special investigations	196	62.8
Small business audit	197	60.6
Special audit	214	53.6
Medium business audit	271	65.7
Large business audit	332	69.0
GST	182	74.7

Source: Analysis of Canada Revenue Agency Appeals Branch database

objection. They do not include time during which the appeals officer may be waiting for the resolution of a similar issue in a court case or for a response from headquarters or another Agency branch (for example, headquarters has 180 days or six months to respond to an appeals officer's request for a legal or other opinion). It is not difficult to see why a complicated dispute can take one or two years to resolve. However, most taxpayers appear willing to wait for an administrative decision before appealing to the courts.

6.33 In an effort to be more responsive to taxpayers and registrants, the Branch now requires that they receive a letter within 30 days of filing an objection; the Agency reports that this requirement is met in most cases. The letter acknowledges that the objection has been received and estimates how long it will take for an appeals officer to contact the taxpayer or registrant. Because an appeals officer has not yet reviewed the objection, however, the letter does not address the specific issues the taxpayer or registrant is disputing. Furthermore, any misunderstanding that the taxpayer or registrant may have about the assessment or any need for further documentation to resolve the dispute is not addressed until an officer reviews the objection. A preliminary review of the objection by an appeals officer and contact with the taxpayer or registrant for more information where needed could help resolve the objection sooner.

Risk to the tax base is assessed inconsistently

Tax base—Income, including capital gains, and commodity transactions of Canadian and non-resident individuals, corporations, and other entities subject to Canadian income taxes, GST, and other taxes

6.34 In our 1998 Report, Chapter 5, Interdepartmental Administration of the Income Tax System, we pointed out that the Agency and the departments of Finance and Justice had adopted and were implementing a strategy for managing the risks to the tax base in the dispute resolution process. The key risk is that legislative deficiencies or administrative shortcomings will not be identified in a timely manner and, as a result, the Crown will have to refund hundreds of millions of dollars to taxpayers and registrants following an unfavourable court decision on a case.

6.35 *The Appeals Branch issued a directive on risk management for income* tax and GST objections in July 2003, updating a 1996 directive. The update defined and discussed risk management and provided a tool for risk detection and assessment. In the following months, headquarters staff made presentations to some regions on the importance of risk assessment. We found inconsistent use of the risk detection and assessment tool in the offices we visited. Our interviews with appeals officers suggested that many had not yet fully grasped the importance of assessing risk or of using the risk detection and assessment tool. Until officers assess the risks of all objections on a consistent basis, the Branch is in danger of not identifying in a timely way any legislative deficiencies or administrative shortcomings that arise through the objections process. We note that the Branch's quality assurance and monitoring reviews have raised similar concerns.

6.36 Risk assessments would also help identify issues for the "important issues" list that the Agency uses as part of the risk management process. Reviewed by a risk management committee and issued quarterly, the list describes current high-risk court cases and indicates the amount of tax at risk in each case. A case is considered to be high-risk if it involves a lot of money or if it has implications for tax policy, tax administration, or social policy.

Tax at risk—The amount of tax that a taxpayer or registrant is disputing

Screener—Appeals officers or clerks responsible for initially reviewing income tax and GST objections to determine whether the objection is valid and to record "tombstone" data before the objection is assigned to an appeals officer

6.37 We found that the screeners are familiar with the important issues list. They use it regularly to determine whether a new objection has issues similar to those on the list. If it does, headquarters is notified so the amount of tax at risk can be included with similar cases on the important issues list, and the objection is set aside until the lead case on the list is resolved. This allows the Agency to keep track of the total tax at risk with each issue, and it prevents officers from making decisions that might be contrary to the law as a result of the decision on the lead case.

6.38 We found that appeals officers are also aware of the important issues list but do not refer to it regularly to ensure that they are not trying to resolve issues similar to those on the list. It is important that appeals officers refer to the list regularly, because they have a better understanding than screeners of the issues in dispute. Furthermore, objections do not always include enough information for the screener to determine whether the issues are similar to those on the list.

6.39 **Recommendation.** The Canada Revenue Agency should

- accurately record, monitor, and report the amounts involved in disputes that are resolved administratively, using estimates where appropriate, to understand the impact of the decisions made by appeals officers and the potential risks to the tax base triggered by objections;
- complete the human resources strategy for the Appeals Branch, including reviewing the competencies and experience required for appeals officers and the related classification levels, and implement it to help ensure that the Branch has the right people at the right levels; and
- develop a plan to strengthen appeals officers' awareness of the importance of managing risks to the tax base and to encourage their use of the tools already in place; implement the plan; and monitor the results.

Agency's response. The Agency agrees with the importance of recording the amounts disputed and resolved and we will capture this information in a cost-efficient manner. We will also ensure that the importance of this issue is reinforced to Agency staff, and the Agency will monitor for consistency in the application of the policy.

The Appeals Branch is in the process of implementing changes to its field office organizational structure. This will include a comprehensive human resources strategy to ensure that linkages between classification, competencies, training, and accountabilities are in place to complement annual and multi-year business plans and budgets.

The process of risk management continues to evolve and the Agency has made significant enhancements to this process. They include an expanded risk management committee, which includes members from other functional areas of the Agency; a risk management working group that leads the identification of important issues and develops strategies thereon; and an ongoing process with field operations to outline the importance of and underlying reasons for risk management, concurrent with the development of regional risk management committees to provide input to the risk management working group.

CPP and EI appeals

Most appeals are not resolved on a timely basis

6.40 The Appeals Branch receives over 5,000 CPP and EI appeals annually. About half of these appeals are of rulings issued by the Agency's Revenue Collections Branch on questions related to whether a worker is an employee or is self-employed. The other half are appeals by employers who have been assessed amounts for CPP and EI that they did not withhold from their employees and remit.

6.41 In 2003–04 the Branch resolved about 4,700 CPP and EI appeals administratively. Historically, about 65 percent of appeals decisions are accepted by those who appealed. The other 35 percent are appealed to the Tax Court of Canada because at least one of the appellants disagrees with the administrative decision and is willing to pursue the issue further. Because often several appellants are involved, and determining whether a worker is an employee or is self-employed is not always a straightforward matter, it can be difficult for the Agency to get agreement from appellants on its administrative decision.

6.42 Timeliness goals set by the Branch for CPP and EI appeals were met only about 46 percent of the time in 2003–04 (Exhibit 6.3). We were told that this rate reflects the increasing number of complex appeals that take longer to resolve.

Exhibit 6.3 Forty-six percent of the timeliness goals for CPP and EI appeals were met in 2003–04

File	Timeliness goal (days)	Files that met goal (percentage)
CPP/EI benefits non-pending	90	55.7
CPP/EI benefits pending	75	43.6
Appeals following an audit	105	44.2
Average of all file types		**46.3**

Source: Analysis of Canada Revenue Agency Appeals Branch database

6.43 We found that appeals officers are impartial in examining the laws and facts that apply to the disputed ruling or assessment. They often send questionnaires to all the parties involved in a disputed ruling and interview some or all of them to double-check the facts in the file or to fill gaps in the information collected by the Revenue Collections Branch's rulings officer. However, the overall process is inefficient because often both the rulings officer and the appeals officer contact the parties to ask for roughly the same information. Furthermore, in resolving disputes administratively the role of appeals officers is not to conduct investigations and determine the facts but to review the facts and the laws that apply to each case. A review of the respective roles of appeals officers and rulings officers and how those roles are being carried out could help identify ways to streamline the overall process.

6.44 **Recommendation.** The Canada Revenue Agency should improve the efficiency of the overall process for Canada Pension Plan and Employment Insurance rulings and related appeals.

Agency's response. The Agency agrees with this recommendation and has already initiated a review of the CPP/EI appeals redress process in 2004, in order to identify and address inefficiencies in the process.

The review is focussed on addressing timeliness and procedural issues and risk management of files; it involves representatives from all program partners, including Human Resources and Skills Development Canada, the Department of Justice Canada, and the Revenue Collections Branch of the Agency.

A preliminary report will be prepared by the end of 2004.

Voluntary Disclosures Program

Response from taxpayers and registrants has been good

6.45 The Voluntary Disclosures Program allows taxpayers and GST (or HST) registrants to correct inaccurate or incomplete information previously reported to the Agency, or to disclose information not previously reported, without penalty or prosecution and sometimes with reduced interest. Its goal is to promote compliance with the tax laws.

6.46 The program has been around for many years. It was administered by the Investigations Division of the Agency until 1999, when it was transferred to the Appeals Branch as part of the Agency's fairness initiative. An information circular published in 1973 indicated that taxpayers who made a complete and voluntary disclosure would not be prosecuted or assessed penalties for gross negligence. This policy was extended to GST registrants in 1991. Amendments to the *Income Tax Act*, introduced in 1991 as part of the government's fairness initiative, gave the Minister of National Revenue the authority to waive or cancel any interest or penalty payable under the Act. An updated information circular on the program was published in 2000 and revised in 2002.

6.47 The number of voluntary disclosure requests increased from 2,500 in 2000–01 to 6,100 in 2003–04; the associated federal income tax and GST (or HST) assessments increased from about $140 million to an estimated $459 million. The $459 million is unusually high, due to two large disclosures. The Agency's records show that the issues most frequently disclosed by taxpayers and registrants are

- domestic business income not previously reported;
- failure to collect and remit GST;
- information returns not previously submitted;
- foreign wages and benefits not previously reported; and
- domestic and foreign interest and dividends not previously reported.

6.48 The Agency has actively promoted the program in recent years and attributes at least some of the increase in disclosures to that promotion. We note that while it is fairly easy to find information about the program on the Agency's Web site, the information is limited to the information circular published in September 2002, although the program has seen several changes since that circular was published (see examples in paragraphs 6.63 and 6.66). The changes are reflected in guidelines to staff but have not been made public so that all taxpayers and registrants would have equal access to the Agency's policies for the program.

6.49 The Agency reviewed its administration of the program and reported the results of that review internally in February 2004. The review highlighted the inconsistent administration of the program across the country, the need to revisit certain policies such as "no-name" or anonymous disclosures (see paragraph 6.59), and the need to capture and analyze performance information to manage the program effectively. The Agency has developed an action plan to address the issues raised in the review and is beginning to implement it.

The way the program's legislative authority is being used raises concerns

6.50 The Agency notes that the legislative authority for the program is subsection 220(3.1) of the *Income Tax Act* and sections 88 and 281.1 of the *Excise Tax Act*. These authorities are similar; essentially they allow the Minister of National Revenue to waive or cancel all or any portion of any penalty or interest otherwise payable under the Acts (amounts waived have not yet been charged; amounts cancelled have already been assessed).

6.51 When subsection 220(3.1) was introduced in 1991, the Department of Finance told Parliament in its Technical Notes that the Minister's discretion to waive or cancel penalties and interest would generally be used in cases where taxpayers had encountered extraordinary circumstances that were beyond their control. The Department gave some examples of extraordinary circumstances:

- natural or human-made disasters such as flood or fire;
- civil disturbance or disruption of services, such as a strike;
- recent serious illness or accident that prevented or delayed the filing of a return or making of a payment; and
- erroneous information received from the Agency in the form of incorrect written answers or errors in published information.

6.52 Further, Parliament was told that the Minister would not use the provision unless the taxpayer had taken a reasonable amount of care in attempting to comply with the requirements of the Act. The Department said that if the taxpayer had delayed paying or complying because of neglect or lack of awareness, the penalty or interest would not be cancelled or waived.

6.53 We support the goals of the Voluntary Disclosures Program and acknowledge the good response from taxpayers and registrants. However, we are concerned that the Agency has gone beyond what Parliament was told the legislation supporting the program would be used for. The overall thrust of the Department of Finance's Technical Notes related to subsection 220(3.1) of the *Income Tax Act* is that the provision is to be used to provide some relief to taxpayers when they find themselves in extraordinary circumstances that are generally beyond their control. In the case of the Voluntary Disclosures Program, many of the disclosures relate to income that was intentionally never reported. Using subsection 220(3.1) to waive the penalties and some of the interest on those disclosures clearly goes beyond the overall thrust of the Technical Notes and may go beyond what Parliament intended the subsection to be used for.

Administration of the program has inconsistencies

6.54 Administering the program is a difficult balancing act. On the one hand, officers want to encourage taxpayers and registrants to correct past errors or omissions and become compliant. On the other hand, they need to ensure that the program is fair to compliant taxpayers and registrants and is not seen as a free ride or a reward for non-compliance. This calls for a lot of judgment on the part of officers, and solid support from headquarters, to ensure that the balance is maintained and the program is administered consistently across the country. We found that the program is not administered consistently, and we are concerned that the balance is not being maintained.

6.55 **Changing use of the program.** The information circular says that taxpayers and registrants may use the program to correct inaccurate or incomplete information or to disclose information not previously reported, without penalty or prosecution. Officers told us that they thought the primary goal of the program was to encourage those who had been evading tax to come forward and set the record straight without fear of penalty or prosecution. In many ways, the information circular and the guidance given to the officers reflect this view. However, officers find themselves handling more and more cases of taxpayers and registrants who want to correct errors made on past returns without incurring a penalty.

6.56 Officers need to use a lot of discretion and judgment in dealing with these different types of disclosures. In some offices, the staff administering the program may not have enough experience and training to exercise their discretion in a way that promotes the consistent administration of the program across the country. Further, there is no job description or classification for officers of the program and no specific training requirements; most Tax Services Offices are using appeals officers. We note that the Agency recently provided its officers with a Web-based self-training module on the program.

6.57 **Enforcement actions invalidate a disclosure.** The information circular says that a disclosure may not qualify as a voluntary disclosure if it is found to have been made with knowledge of an audit, investigation, or other enforcement action initiated by the Agency. We found that officers checked to see whether there was any enforcement action underway before approving a voluntary disclosure. In most cases this was a relatively easy task. In some cases an enforcement action had started but the taxpayer or registrant had been unaware of it, so the disclosure could still be considered voluntary.

6.58 In a few cases, the taxpayer or registrant was aware that an audit was underway. In such situations, officers are advised to use their discretion in determining how closely the audit relates to the voluntary disclosure the taxpayer or registrant has attempted to make. Only if there is a close connection will the disclosure be considered invalid. For example, if auditors were doing a restricted audit (an audit that focusses on one to three issues) of income tax issues and the taxpayer/registrant wanted to make a voluntary disclosure related to GST, the disclosure would probably be considered valid because it is unlikely that the audit would have discovered a GST issue. Given the changing use of the program, it is likely that officers will have to make more of these judgment calls.

6.59 **Anonymous or "no-name" disclosures.** The information circular points out that those who are unsure that they want to make a voluntary disclosure are entitled to discuss their situation anonymously or as a hypothetical case. We found inconsistencies in the application of this policy from office to office.

6.60 The program provides protection from penalties and prosecution on the understanding that the disclosure is voluntary, complete, and not triggered by an Agency enforcement action such as an audit. In the case of an anonymous disclosure, it is not clear when that protection begins. Some officers told us they would give protection from the date of the first contact, when they would likely have little information about the taxpayer or registrant, the amounts involved, and whether the disclosure would even qualify under the program. Other officers told us they would give protection only from the date when they had enough information to determine that the disclosure could be accepted under the program. Still other officers felt that no protection should be provided until the name of the taxpayer or registrant was revealed.

6.61 The guidelines state that protection should be granted from the date on which the taxpayer or registrant is identified or when the Client Agreement Form is signed, whichever date is earlier. There is a risk in providing protection too early, before the officer has enough information to determine that the disclosure can be accepted under the program. But being too strict risks discouraging non-compliant taxpayers and registrants from coming forward.

6.62 We noted one GST case that highlights the difficulties with anonymous disclosures and enforcement actions (see page 16, A voluntary disclosure of goods and services tax). The issues the Agency had to deal with were the effective date of protection for an anonymous disclosure and whether an enforcement action had been initiated before that date. Complicating this case was the difficulty of calculating the amounts involved and the length of time it took from the initial contact to the disclosure of the name of one of the companies involved. As we have noted, applying the program is a balancing act. At the same time, we believe that taxpayers and registrants should have to identify themselves fairly early if they want to receive the program's protection from penalties and prosecution.

6.63 **Interest relief.** While the information circular makes no mention of interest relief under the program, the guidance given to officers does—it says that taxpayers and registrants are expected to pay a reasonable amount of interest. But it also authorizes officers to consider relief of part of the interest charged on assessments of older-year returns. In particular, officers may consider reducing the interest rate by 4 percent for income tax assessments on the years preceding the latest three years for which returns were required. For example, a taxpayer voluntarily discloses that she did not report dividend income from an offshore investment for the years 1995 to 2002. Using the guidance, the officer would consider reducing the interest rate by 4 percent for the years 1995 to 1999. The guidance goes on to say that there may be

A voluntary disclosure of goods and services tax

Several GST registrants, some of whom were related, discovered in the spring of 2000 that they had made an error in remitting the GST on certain transactions. The registrants' representative contacted a Voluntary Disclosures Program officer in May 2000 to say that the registrants wanted to voluntarily disclose the error to avoid the penalties that normally would be charged. No names and few details were provided to the Agency at that time.

Agency officers and the representative continued to discuss the issue until May 2002, when the representative signed the Client Agreement Form on behalf of the registrants and provided specific information about the error, including an estimate of the amounts and the number of companies involved. However, the names of the companies still were not disclosed, and their representative asked that the effective date of protection under the program be 1 May 2000, the date when the Agency was first contacted.

In September 2002, the representative again wrote the Agency noting that one of the companies, still unnamed but called B company, had been contacted for a GST audit in April 2002. The audit would include part of the period covered by the proposed voluntary disclosure. The representative argued that under the Voluntary Disclosures Program the company should still be entitled to protection, because the effective date of protection was 1 May 2000 (according to the Agency's policy, it should have been May 2002, the date the Client Agreement Form was signed, but local officers decided to override the policy). The auditor was not told that B company had applied for a voluntary disclosure.

In June 2003 the representative wrote to the Agency, indicating that the GST auditor was proposing to assess B company for the tax on transactions that were part of the proposed voluntary disclosure, as well as the related interest and penalties. The representative then identified the company. After much discussion, the Agency agreed in February 2004 to accept the disclosure as voluntary and to waive the penalties and interest that would have been assessed after the audit.

exceptional circumstances that warrant interest relief of more than 4 percent, but it does not give any criteria to consider in making that decision.

6.64 We found that officers were automatically reducing the interest rate by 4 percent on all voluntary disclosures that covered more than three taxation years, without considering whether the interest that would then be paid was a reasonable amount based on the nature of the disclosure. Headquarters officials had advised them to proceed in this way so that the rate of interest paid on voluntary disclosures would be the same as the government's Treasury Bill rate over the short term.

6.65 **Inconsistency with the "fairness provisions."** Under legislation referred to as "fairness provisions," the Agency can waive or cancel all or part of any interest or penalty owed by a taxpayer because of a delay or error by the Agency, circumstances beyond the taxpayer's control, or the taxpayer's inability to pay. The goal is to help taxpayers resolve problems that arise in these situations. Fairness requests are handled by staff at all Tax Services Offices and Tax Centres. Each request is considered separately, and the decision takes into account the facts presented by the taxpayer. The Appeals Branch has overall responsibility for co-ordinating the use of the fairness provisions. In our view, the policy of automatically providing interest relief for

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6.66 **Years to be assessed.** Voluntary disclosures must be complete disclosures. However, some amounts that are disclosed may not be assessed. While the information circular does not discuss this, the guidance given to officers does. For example, if a taxpayer knowingly has not reported income from offshore investments for the last 20 years, the taxpayer must disclose this and the officer has to determine how much of that income is to be assessed. Making that decision means finding the balance between what the taxpayer owes and what the taxpayer is willing to pay to become compliant, taking into account that the result also has to be fair to taxpayers who have been compliant. The guidance states that when omissions have occurred in any of the most current six years for which taxes are due, the officer should include those years in the assessment. But when the omissions also occur in years other than the most current six, the officer must determine whether other years should also be included by considering factors such as

- how material the omission is in relation to the amounts originally reported;
- whether a significant portion of the omission relates to years prior to the most current six;
- the taxpayer's or registrant's compliance history; and
- how long the taxpayer or registrant has been non-compliant.

6.67 We found that there were significant inconsistencies in the way this guidance is followed across the country. Taxpayers and registrants in similar circumstances are not being treated consistently.

Analysis of results is needed

6.68 The Agency is collecting some information on the Voluntary Disclosures Program. Each quarter, officers report the number of cases closed, the types of issues disclosed (such as failure to collect and remit GST), and the amounts of additional tax assessed. However, the Agency is not using this information in any detail to determine whether the program is meeting its objectives or to help it manage the program. In part this is because officers are not reporting the information consistently, and there is no computer program to roll up the results.

6.69 Nor is the Agency analyzing the types of cases being processed under the program. This is important information because it can indicate sources of non-compliance, information that would help the Compliance Programs Branch improve its compliance programs. For example, in 2003–04 the largest number of voluntary disclosures dealt with previously unreported domestic business income. This would suggest that the Compliance Programs Branch should review the work it does to detect unreported domestic business income.

6.70 The Agency is not following up on taxpayers and registrants who have come forward through the Voluntary Disclosures Program to ensure that they remain compliant. This is particularly important to prevent misuse of the program.

6.71 **Recommendation.** The Canada Revenue Agency should

- implement its February 2004 action plan, with particular emphasis on aspects designed to ensure that the program is administered consistently across the country;
- analyze the results of the program to determine whether its objectives are being met; and
- follow up on taxpayers and registrants that have used the program to ensure that they remain compliant.

Agency's response. The Agency agrees with the recommendation and has started the following:

- Implementing the February 2004 action plan that will address consistency issues.
- Enhancing the analysis capacity of the Appeals Branch.
- Monitoring periodically and addressing risk associated with future non-compliance. A review is currently underway to identify, analyze, and assess ongoing compliance of clients, and based on the results, we will be incorporating voluntary disclosures into the Agency's issue-based risk assessment system.

The Agency notes that the Auditor General believes the CRA has gone beyond what Parliament was told the legislation supporting the Voluntary Disclosures Program (VDP) would be used for. The Agency maintains, with the reassurance of the Department of Justice Canada, that the intent of Parliament is contained in the words of the acts as passed by Parliament. Furthermore, since enactment of the legislation in 1991, circumstances covered by the VDP policy have been the subject of various parliamentary debates.

Conclusion

6.72 The Appeals Branch is resolving objections to income tax and GST assessments in a way that is fair and impartial. As well, over half of the objections are resolved within the timeliness goals the Agency has set. However, taxpayers can appeal their case to the Tax Court of Canada if they have not received a decision from the Appeals Branch after 90 days. Many of the Branch's timeliness goals for income tax objections exceed 90 days by a large margin. The Agency needs to ensure that appeals officers fully grasp the importance of assessing the potential risks to the tax base from the objections they review and completing the risk assessments regularly.

6.73 The Appeals Branch is having difficulty resolving appeals of CPP and EI rulings and assessments in a timely way, although it resolves them impartially. More work is needed to improve the efficiency of the overall process for CPP and EI rulings, which are issued by the Revenue Collections Branch, and any related appeals of those rulings, which are dealt with by the Appeals Branch.

6.74 Taxpayers and registrants are using the Voluntary Disclosures Program to become compliant, by correcting inaccurate or incomplete information previously reported to the Agency or by disclosing information not previously reported. However, the program's inconsistent administration across the country raises concerns about whether the Agency is protecting the tax base. As well, we are concerned that the Agency has gone beyond what Parliament was told the legislation supporting the program would be used for.

About the Audit

Objectives

The objectives of the audit were to determine

- whether the Appeals Branch of the Canada Revenue Agency is resolving objections to income tax and GST assessments and appeals of CPP/EI rulings and assessments in a way that is fair, timely, and impartial; and
- whether the Voluntary Disclosures Program is encouraging compliance and protecting the tax base.

Scope and approach

The audit focussed on the Agency's policies and procedures for reviewing

- notices of objection from taxpayers and registrants who disagree with the Agency's decisions in income tax and GST; and
- appeals from workers, employers, the Minister of Social Development (for CPP), or the Employment Insurance Commission (for EI) who disagree with the Agency's rulings and assessments on CPP and EI.

The audit also reviewed the Agency's administration of the Voluntary Disclosures Program, which allows taxpayers and registrants to correct inaccurate or incomplete information previously reported to the Agency, or to disclose information not previously reported, without penalty or prosecution and sometimes with reduced interest.

We did not include the fairness provisions which provide for forgiving interest and penalties to taxpayers unable to comply with the law due to circumstances beyond their control. The administration of these provisions was covered in our 2002 Report, Chapter 2, Tax Administration: Write-Offs and Forgiveness. We also did not include the Branch's work in the area of litigation, which was covered in our 1998 Report, Chapter 5, Interdepartmental Administration of the Income Tax System.

We conducted our audit work at the Agency's head office, eight Tax Services Offices, and two Tax Centres. We reviewed selected cases, interviewed management and staff, and analyzed data, monitoring reports, and other information provided by the Agency.

Criteria

Our audit was based on the following criteria:

- Reviews and decisions should be based on an impartial examination of the laws and facts applicable to the contested Agency decision.
- Performance goals should be established for timeliness in completing appeals decisions, and actual completion times should be measured against the set goals.
- The Agency should have a risk management strategy, and to protect the tax base it should implement a process for dealing with risks related to objections and appeals.
- The Agency should ensure that the objections and appeals process is transparent.
- The Agency should have a strategy and implement a process to ensure that it has the right people in the right place at the right time and that they are adequately trained to do the work assigned.
- The Agency should monitor and analyze the results of disputes to determine how effective it is in resolving contested decisions and to improve its effectiveness.
- The Voluntary Disclosures Program should be designed and implemented in such a way that it encourages non-compliant taxpayers to comply while at the same time protecting the tax base. The implementation of the procedures should be monitored regularly.
- The Agency should have adequate information about the Voluntary Disclosures Program to ensure that it is meeting its intended objectives.

- The Voluntary Disclosures Program should operate within the legislative authority provided to the CRA and the fairness policies established by the CRA.

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to the House of Commons

NOVEMBER

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Process for Responding to Parliamentary Order Paper Questions

Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

7

Process for Responding to Parliamentary Order Paper Questions

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Process for Responding to Parliamentary Order Paper Questions

Main Points

7.1 The written questions (order paper questions) that members of Parliament submit to the government are an important part of the parliamentary system. They are among the tools that members of Parliament can use to hold the government to account. In February 2004, the Governor in Council asked our Office to carry out an audit of the second response to Order Paper Question 37, provided in January 2004. It relates to transactions with the holdings of the blind management agreement of the former Minister of Finance. In preparing its response the government used the time period of January 1993 to October 2003, which was the longest time period possible for the response.

7.2 Except for the effect of the practices noted below, we have concluded that the process was sufficient for the response to Order Paper Question 37 dated 28 January 2004, in the amount of $161 million, to be reasonably complete with respect to grants, contributions, and contracts from the government. Port authorities, as shared governance organizations, were not asked to respond to Question 37 because, in the opinion of the government, these kinds of organizations are not considered to be part of government. In our opinion the port authorities, which are included in the Public Accounts of Canada as part of the government, are agencies of government and should have been tasked with responding to the question. We cannot quantify the effect on the government's response of the practice of not seeking information from all relevant organizations.

7.3 The government exercised considerable oversight in developing the second response to Question 37. We noted that the process followed was more rigorous than for the first response. While recognizing the limitations of government systems and the difficulties in responding to questions that cover long periods of time, we noted that there was room for improvement.

7.4 In addition, the response did not include the government's guarantee of a $10 million loan by a commercial bank to a company included in the holdings of the blind management agreement of the former minister of Finance between November 1993 and November 1994. The loan guarantee was issued in June 1993, before the start date of the blind management agreement in November 1993. The CSL Group Inc., which was one of several companies that had a minority interest in the company, disposed of its interest in November 1994. The government, which was the majority shareholder in the company, made no payments in connection with this guarantee.

7.5 In March 2004, as a result of difficulties encountered in preparing a response to Question 37, the Government House Leader announced a series of reforms intended to ensure that parliamentarians would receive adequate information in responses to their questions. For example, the Privy Council Office may designate a lead department to co-ordinate, review, and validate responses to complex, horizontal questions that involve several departments and agencies. Also, the Privy Council Office is now asking departments to designate a senior official to sign a statement of completeness certifying that the information in the response is complete and accurate. While these are positive initiatives, they have yet to be fully implemented.

7.6 In addition to Question 37, we audited four other order paper questions. We have concluded that the process used to answer those four questions, as was the case for the first response to Question 37, led to incomplete responses. The reasons for the incomplete responses include the following:

- Key terms were not defined by the Privy Council Office.
- There was a lack of appropriate level of care by departments in searching for information.
- There was a failure of organizations to provide the requested information in their responses.

This conclusion cannot be generalized to responses to all order paper questions.

7.7 Additional measures, beyond those announced by the government in March 2004, are needed to strengthen the process of responding to order paper questions. Such measures would include, for example

- clarifying the questions to ensure more relevant, useful responses;
- providing members of Parliament with contextual information and the limitations in preparing the response;
- obtaining full responses from all relevant Crown corporations;
- strengthening departmental search procedures;
- presenting responses in an aggregated format, which could be more useful to a member of Parliament; and
- updating the Privy Council Office's process for tracking questions and responses.

7.8 In the case of Question 37, we noted that the process for completing the public declaration of declarable assets should be strengthened by requiring the trustee to certify that the information provided to the Office of the Ethics Commissioner is complete.

7.9 The government should address the recommendations set out in this report to strengthen the process that supports an important aspect of our Parliamentary system of government—the right of members of Parliament to receive the information necessary to hold the government to account.

Background and other observations

7.10 The Government of Canada is a large and complex organization. Information systems vary within departments and across government. It can therefore be difficult to get complete and accurate information to answer questions from members of Parliament, particularly those that ask for information over longer periods of time.

7.11 The government faces a significant number of challenges in responding to order paper questions. These include

- changes in the structure of government departments over time,
- changes to government information systems and the introduction of new systems,
- the government's policy of retaining records for the current year and the previous six years, and
- departmental information systems designed to meet management's needs and not necessarily structured in a way that supports responses to order paper questions.

The government has responded. The government is in agreement with our recommendations. Its responses are included throughout the chapter.

Introduction

7.12 In February 2004 the Governor in Council requested the Auditor General of Canada to conduct an audit under Section 11 of the *Auditor General Act* to inquire into and report on the following three questions:

- Was the answer provided to Order Paper Question 37 on 28 January 2004 a satisfactory response based on the information that the government possessed?
- Are the reforms proposed by the Leader of the Government in the House of Commons to handle order paper questions sufficient to ensure adequate information is provided to parliamentarians?
- If the reforms are not sufficient, what other steps should be undertaken, including, but not limited to, reforms to the government's information systems?

7.13 **Question 37.** Question 37 asked, "Since 1993, what grants, contributions, contracts and/or loan guarantees made either through a Crown corporation, department, and/or agency of the government were received by the holdings of the 'Blind Trust' of the former Minister of Finance specifying the source and dollar amount, date made, reason(s) for providing the funding, and present status of the grant, contribution, and / or loan guarantee, (whether repaid, partially repaid or unpaid—including the value of the repayment—in the case of contracts please specify whether the contract is fulfilled, whether it was tendered and any reason for limiting the tender)?"

The importance of written questions within the parliamentary system

Our description of the rules of the House in paragraph 7.14 is based on *House of Commons Procedure and Practice*, (2000) Marleau, Robert; Montpetit, Camille.

7.14 Members sit in the House of Commons to serve as representatives of the people who have elected them to that office. They have wide-ranging responsibilities which include work in the Chamber, committees, their constituencies and political parties. . . . Besides participating in debates in the Chamber and in committees, and conveying their constituents' views to the government and advocating on their behalf, Members also have responsibilities in many other areas:

- They act as ombudsmen by providing information to constituents and resolving problems.
- They act as legislators by either initiating bills of their own or proposing amendments to government and other Members' bills.
- They develop specialized knowledge in one or more of the policy areas dealt with by Parliament, and propose recommendations to the government.
- They represent the Parliament of Canada at home and abroad by participating in international conferences and official visits. (186-7)

The right to seek information from the Ministry of the day and the right to hold that Ministry accountable are recognized as two of the fundamental principles of parliamentary government. Members exercise these rights principally by asking questions in the House. . . . [T]he search for or clarification of information through questioning is a vital aspect of the duties undertaken by individual Members. Questions may be asked orally without notice or be submitted in writing after due notice. (415)

Provisions allowing for written questions to be posed to the Ministry and to private Members have been included in the rules of the House of Commons since 1867. (439)

In general, written questions are lengthy, often containing two or more subsections, and seek detailed or technical information from one or more government departments or agencies. Restrictions governing the form and content of written questions are found both within the rules and as a result of custom, usage, and tradition. . . . With time, and following several Speakers' decisions, the list of restrictions grew very long. Concurrently, some became outdated or irrelevant. Thus, a very large measure of responsibility for ensuring the regularity of written questions fell to the Clerk [of the House]. Aside from a 1965 Speaker's statement, indicating that some of these restrictions no longer applied, there is no definitive [list of restrictions]. (440-41)

A written question is judged acceptable if it satisfies the general guidelines for oral questions and the restrictions provided in [the procedural] rules. The purpose of a written question is to obtain information, not supply it to the House. A question must be coherent and concise and the subject matter must pertain to 'public affairs'; 'no argument or opinion is to be offered, nor any facts stated, except so far as may be necessary to explain the same.' (441)

The guidelines that apply to the form and content of written questions are also applicable to the answers provided by the government. As such no argument or opinion is to be given, and only the information needed to respond to the question is to be provided in an effort to maintain the process of written questions as an exchange of information rather than an opportunity for debate. It is acceptable for the government, in responding to a written question, to indicate to the House that it cannot supply an answer. On occasion, the government has supplied supplementary replies to questions already answered. (443)

There are no provisions in the rules for the Speaker to review government responses to questions. Nonetheless, on several occasions, Members have raised questions of privilege in the House regarding the accuracy of information contained in responses to written questions; in none of these cases was the matter found to

> be a . . . breach of privilege. The Speaker has ruled that it is not the role of the Chair to determine whether or not the contents of documents tabled in the House are accurate nor to 'assess the likelihood of an Hon. Member knowing whether the facts contained in a document are correct.'(443)

7.15 Exhibit 7.1 presents some examples of the many restrictions in force for written questions, as taken from *Beauchesne's Parliamentary Rules and Forms of the House of Commons of Canada*.

Exhibit 7.1 Some restrictions governing the form and content of written questions

A written question must not

- be of unreasonable length;
- be ironical, rhetorical, offensive, trivial, vague, meaningless, or hypothetical;
- contain an expression of opinion, epithet, innuendo, satire, ridicule, inferences, imputations, or charges of a personal character;
- repeat in substance a question already answered;
- ask the government's opinion on matters of policy;
- raise a matter of policy too large to be dealt with in the limits of an answer to a question;
- criticize decisions of the House; and
- seek information on secret matters, such as decisions or proceedings of Cabinet, or advice given to the Crown by law officers.

Source: *Beauchesne's Parliamentary Rules and Forms of the House of Commons of Canada* (with Annotations, Comments and Precedents), 6th edition, (1989) Fraser, Alistair; Dawson, W.F.; and Holtby, John. Adapted by permission of Carswell, a division of Thomson Canada Limited.

Description of process for written questions

Order Paper—The official agenda of the House, produced for each sitting day, and listing all items that may be brought forward in the Chamber on that day.

7.16 A number of steps are associated with the process for order paper questions. These steps are intended to help ensure that a member of Parliament who submits a question receives a response that contains the requested information. Exhibit 7.2 describes the process for responding to a typical Order Paper question such as Question 37—the main subject of this audit.

7.17 A total of 385 written questions were asked in the 36th Parliament and 586 in the 37th Parliament. The members of Parliament requested a response within 45 days for about 70 percent of the questions posed. Of those questions, 91 percent were answered within the 45-day period.

Focus of the audit

7.18 The focus of our audit was to assess whether the process followed for the second response to Question 37 was sufficient to provide a reasonably complete response to Parliament and whether the reforms announced were sufficient to ensure adequate information is provided to parliamentarians.

Public declaration of declarable assets—For purposes of a blind management agreement, the public declaration of declarable assets lists the assets that a public office holder has in the agreement.

Public office holder—A public office holder can be a minister of the Crown, a secretary of state, a parliamentary secretary, or a person other than a public servant who works for a minister of the Crown or a minister of state; a Governor in Council appointee (with a few exceptions) or full-time ministerial appointee designated by the appropriate minister of the Crown.

7.19 To assess the adequacy of the reforms, we selected two other order paper questions answered before the government's reforms were announced, to document and test the process used to respond to order paper questions at that time. We also selected two order paper questions that members of Parliament asked after 2 March 2004, the date on which the government's reforms were to be implemented. Our audit of these two questions tested whether the reforms were working as intended. Our assessment of the responses to Question 37 and the four other order paper questions took us into many government departments, Crown corporations, and agencies. We also examined the process of preparing the public declaration of declarable assets by the former minister of Finance and how it was monitored by the former Office of the Ethics Counsellor.

7.20 Given the limitations to the government systems, the 10-year period covered by the question, and the policy on records retention, it was not feasible for the government or for us to provide assurance on whether the answer to Order Paper Question 37 was complete. We examined the process that was followed to respond to Question 37 to determine whether the government provided a reasonably complete response to Parliament based on the information that the government possessed and given the inherent limitations of those systems. The audit did not include an assessment of the process used to award contracts to the companies involved. We could not audit the use of sub-contractors because the information is not contained in the government's information systems. Nor did we audit the completeness of the list of holdings in the blind management agreement of the former minister of Finance because this information relates to privately held companies, including The CSL Group Inc. Auditing such information is outside the mandate of the Auditor General of Canada. (Question 37 referred to a "blind trust." The arrangement is actually called a blind management agreement.)

Blind management agreement—It is one of the mechanisms that a public office holder uses to comply with the Conflict of Interest and Post-Employment Code for Public Officer Holders. It places the assets of the public office holder in the hands of a manager who is at arm's length. The manager exercises all of the rights and privileges associated with those assets.

7.21 Finally, the determination of whether a response is satisfactory or not is a judgment that appropriately rests with members of Parliament. We assessed whether the process followed for the second response to Order Paper Question 37 was sufficient to provide a reasonably complete response to Parliament.

7.22 For more information on the audit, see **About the Audit** at the end of the chapter.

Observations and Recommendations

Challenges in responding to questions

7.23 The government can face a significant number of challenges in responding to order paper questions. These include

- the complexity of an organization as large and diverse as the Government of Canada,
- changes in the structure of government departments over the time period covered by many order paper questions,

Exhibit 7.2 Process used until March 2004 to respond to an order paper question

Member of Parliament—A member of Parliament forwards his or her question to the Clerk of the House. The Clerk, acting for the Speaker, ensures that the question complies with the rules of the House and that the member has no more than four questions on the Order Paper at any one time. The question is given a number and translated. The question appears once on the Notice Paper and then is transferred to the Order Paper.

The Privy Council Office—The Office of the Co-ordinator of Parliamentary Returns, in the Privy Council Office, scans the Notice Paper daily for new questions. The question is analyzed and assigned.

A notice is sent by courier to responsible departments, agencies, and Crown corporations with the question and instructions, if applicable. The Office indicates

- whether it is a ministerial question (one minister responds) or a shared question (more than one minister responds),
- which organization is tasked with responding to the question, and
- whether the member of Parliament requested a response within 45 calendar days.

Departments—A parliamentary returns officer in each organization ensures that the question is actually the responsibility of that organization. If the question is not within its jurisdiction or if other organizations should be added, the officer advises the Office of the Co-ordinator of Parliamentary Returns. If organizations need clarifications, they must call the Office. If there is only one respondent, the department may call the member of Parliament directly.

The returns officer forwards the question to the appropriate branches with instructions and a deadline date. All answers to a question should be prepared as of the date of the question.

After receiving a response from the branches, the returns officer edits the response, sends it for approval to the appropriate head, has it translated, prepares a formal reply, and forwards it to the minister or parliamentary secretary for signature. All background information should accompany the response for briefing. The returns officer sends the response, by hand and by facsimile, to the Office of the Co-ordinator of Parliamentary Returns.

The Privy Council Office—Responses are put together into one document by the Office of the Co-ordinator of Parliamentary Returns. A review may be conducted including consulting previous responses, other respondents' responses, and official publications. Responses that are ready for tabling are sent to the Leader of the Government in the House of Commons or the Parliamentary Secretary and indicates the intended disposition of each question.

Leader of the Government in the House—The Leader reviews the responses and may release the information to the House or request that organizations do additional work.

If the member of Parliament had asked for the response to be read in the House, the Parliamentary Secretary to the Leader of the Government will generally do so. In most instances, however, unanimous consent is needed to have the response read into the record. The response is printed in the *Debates of the House of Commons* as if it had been read. When responses are particularly lengthy, the Parliamentary Secretary will seek unanimous consent to transfer the question into an order for return. The return is then tabled, and the document is given a sessional paper number. The material remains in the custody of the Clerk of the House and is also accessible at the Library of Parliament.

Standing committee—If a question remains unanswered at the end of the 45 days, the matter is referred to the appropriate standing committee. Within five sitting days of such a referral, the chair of the committee convenes a meeting where a department could be called to explain its failure to respond to the question within the specified time. However, if the member who asked the question chooses to rise in the House under "Questions on the Order Paper" and give notice that he or she intends to transfer the question and raise it when the House adjourns, then the order referring the matter to a committee is discharged.

- changes to government information systems and the introduction of new systems,
- the government's policy of retaining records for the current year and the previous six years, and
- departmental information systems designed to meet management's needs and not necessarily structured in a way that supports responses to specific order paper questions.

7.24 As information systems can vary within and between departments, it can be difficult to extract information to respond to members of Parliament's questions. For example, in many cases, it is first necessary to determine which companies the government has done business with. We found that the codes used to identify companies or "vendors" differ within and among departments. The same company can have several different vendor codes to identify it. Accordingly, it is difficult to ensure that all government dealings with companies have been identified and included in the response to a question. The use of a common vendor name and code to identify companies doing business with the government would have facilitated searches for information at a government-wide level and provided useful management information.

Challenges unique to Question 37

7.25 Responding to Order Paper Question 37 introduced further challenges such as the complexity of the corporate structure of the assets contained in the blind management agreement of the former minister of Finance. The list of assets included numerous companies and subsidiaries, many of which had their own subsidiaries and divisions, all with varying degrees of ownership. In addition, there were many changes to these companies and subsidiaries during the 10-year period covered by Question 37. Most companies listed in the blind management agreement were related to marine activities, transportation, and shipbuilding. One company was a consulting firm, and that required that the question be answered by several departments, agencies, and Crown corporations it may have done business with.

7.26 Another challenge in responding to Question 37 relates to the determination of what time period should have been covered by the response. Different interpretations of the starting date that could have been used in preparing the response to the question include a response based on the calendar year (starting with January 1993), the fiscal year (starting with April 1993), or the effective date of the blind management agreement (November 1993 when the former minister of Finance was appointed to cabinet). Similarly it was necessary to establish an end date for the second response to Question 37. Various interpretations that could have been used include an end date based on the time Question 37 was first asked (October 2002), the time Question 37 was re-asked (October 2003), or the date the blind management agreement ceased to exist (June 2002 when the former minister of Finance resigned from cabinet). Each interpretation would have resulted in a different response to the question. The government used the time period of January 1993 to October 2003 in preparing the second response, which was the longest time period possible for the response.

7.27 Exhibit 7.3 lists key events in responding to Question 37 from the date it was first asked until departments, agencies, and Crown corporations received new instructions on how to handle order paper questions.

7.28 As noted in Exhibit 7.3, the member of Parliament for Edmonton Southwest received a revised response to his question in January 2004. The request we received on 4 February 2004 to carry out this audit asked us, among other things, to determine whether the revised response was satisfactory. In the following section we present our observations with respect to this response.

The second response to Question 37

7.29 As noted in Exhibit 7.3, in October 2003, two members of Parliament raised questions about whether the initial response to Question 37 was complete and accurate. Their questions arose after they had detected inaccuracies in the government's initial response to Question 37.

7.30 In preparing the second response, the Privy Council Office exercised greater care and considerable oversight to ensure that the second response was complete and provided a summary of the information including details from departments, agencies, and Crown corporations. Based on the departmental responses, the Privy Council Office provided information on 420 contracts, and 128 amendments to them, with companies and subsidiaries held in the blind management agreement. The second response to Question 37 also provided information on three contributions.

Contribution—A conditional transfer payment to an individual or organization for a purpose that is agreed to in a contribution agreement. The agreement and the payment are subject to audit.

Exhibit 7.3 Key events in responding to Question 37

24 October 2002	The member of Parliament for Edmonton Southwest tables Question 37.
1 November 2002	The former Ethics Counsellor transmits the 2002 public declaration of declarable assets to the Privy Council Office. The declaration lists the assets that the former Minister of Finance had in a blind management agreement. The information was used by government entities in preparing the first response.
14 February 2003	The Leader of the Government in the House tables the first response.
21 October 2003	The member for Medicine Hat and the member for Fraser Valley question the accuracy of the government's response.
22 October 2003	The Leader of the Government in the House asks that government officials review the response and provide additional information, if necessary.
23 October 2003	The former Ethics Counsellor provides the Privy Council Office with a revised list of companies as of 14 February 2002, which included the dates of their acquisition and disposal.
6 November 2003	The Privy Council Office resubmitted the question to government entities to get a more accurate response.
28 January 2004	The Leader of the Government in the House sends a revised response to the member for Edmonton Southwest and announces reforms for responding to order paper questions.
4 February 2004	An Order-in-Council asks the Auditor General to conduct an audit.
6 February 2004	The Government House Leader tables the second response.
2 March 2004	Departments receive revised instructions for responding to order paper questions in accordance with the announced reforms.

7.31 To prepare their responses, government entities were given a revised list of companies that included declarable assets over the 10-year period. The former Office of the Ethics Counsellor had prepared the declaration and updated it annually based on information provided by the supervisor of the blind management agreement.

Grants, contributions, and contracts were reasonably reported

7.32 On an annual basis the government expends billions of dollars on grants, contributions, and contracts for services in support of the delivery of its programs and services to Canadians. Accordingly, we expected departments, agencies, and Crown corporations to have information systems in place that would allow them to manage programs and to respond to enquiries concerning the expenditure of public monies. In setting this expectation, we recognize that systems are designed to meet management information needs and may not necessarily capture information that is the subject of an order paper question. We also recognize that there are limitations in the ability of departments to respond as a result of the government's policy for retaining records. This policy does not require departments to retain records for more then the current year, plus the previous six years.

7.33 **Grants and contributions.** We found that the response prepared by Transport Canada did not identify contributions of $5 million made to the Canarctic Shipping Company Limited, a corporation in which The CSL Group Inc. was a minority shareholder during the period from 1993 to 1994. In preparing its response, the Department indicated that it followed its normal practice of conducting a search of its electronic records for the current year and the previous six years. This practice, which is designed to allow the Department to trace amounts reported in the Public Accounts tó the supporting documentation, did not identify any payments for the seven-year period of the search. We noted that the Department's normal practice did not include a review of financial documents such as the public accounts, their estimates, and departmental performance reports. These documents were available for the 10-year period covered by Question 37. We identified the non-disclosed contributions through a review of the departmental estimates and Public Accounts of Canada. In our opinion it would have been reasonable to have searched these publicly available records for the period covered by the order paper question.

7.34 Similarly we found, by searching the Public Accounts of Canada that the National Transportation Agency, now known as the Canadian Transportation Agency, made contributions amounting to $1 million during the period from 1993 to 1996 to a division of another company listed in the public declaration of declarable assets. These contributions had not been identified and disclosed by the Canadian Transportation Agency. Because the payments were made to the division of the company in question, it was not obvious that it referred to the same company that was listed in the public declaration. We were only able to confirm this was a relevant division and company by confirming it with The CSL Group Inc.

7.35 **Contracts for services**. In preparing the summary tables for the 420 contracts and 128 amendments in the second response to Question 37, the Privy Council Office inadvertently listed some contracts twice. This duplication resulted in an overstatement of the response by $5.2 million. Furthermore, based on information received from Fisheries and Oceans Canada, the Privy Council Office listed contract amendments of $1.4 million that were outside the scope of the question. The total amount of the overstatement with respect to contract payments included in the second response resulting from the above errors was $6.6 million.

7.36 The effect of the errors—the undisclosed contributions of $6 million combined with the overstatement of $6.6 million in contracts paid to companies listed in the public declaration—resulted in a net effect of overstating the second response of $161.8 million by an amount of $0.6 million for grants, contributions, and contracts.

A loan guarantee was not included

7.37 Order Paper Question 37 asked the government to provide information on loan guarantees it had provided to companies listed in the blind management agreement. We noted that Transport Canada did not report the fact that the Government of Canada, which was the majority shareholder of Canarctic Shipping Company Limited, had provided a loan guarantee of $10 million, in June 1993. This guarantee was issued before the start date of the blind management agreement in November 1993. The guarantee was used by the Company to secure a loan from a commercial bank. During this period of time the CSL Group Inc. and several other companies had a minority interest in the company. The CSL Group Inc. disposed of its interest in November 1994. The government made no payments in connection with the loan guarantee.

7.38 In preparing its response, Transport Canada searched its electronic records of transactions for a seven-year period. Because no payments had been made by the government on the loan guarantee, no records were found as a result of this search. We note that information concerning this loan guarantee was disclosed in the Department's estimates and performance reports. In our view the Department should have searched publicly available financial documents for the time period covered by the question.

7.39 Even though there was no money expended by the government for this loan guarantee, this information was within the scope of the member's question and should have been included in Transport Canada's response.

Not all relevant information requested

7.40 In co-ordinating the government's second response to Order Paper Question 37, the Privy Council Office followed a number of long standing practices that resulted in not all relevant information being requested. These practices include

- accepting that Crown corporations may not provide information in their responses on the grounds of commercial sensitivity, and

- not asking shared governance corporations to respond to order paper questions.

Any additional grants, contributions, contracts, and loan guarantees that would have been reported if the Privy Council Office had not followed these practices, cannot be quantified.

7.41 **Canada Post did not provide any information in its response.** We note that of the three Crown corporations listed under Schedule III Part II of the *Financial Administration Act*, two—the Royal Canadian Mint and the Canada Development Investment Corporation—provided the information requested.

7.42 The Canada Post Corporation did not provide any information in its response, indicating that "the contracted services are considered privileged and commercially sensitive and cannot be specified." We have also noted that the Canada Post Corporation did not provide information in its responses to 37 of the 43 other order paper questions tasked to it in the 37th Parliament, citing the same rationale.

7.43 The government could have required the Canada Post Corporation to respond under two sections of the *Financial Administration Act* (Exhibit 7.4).

Exhibit 7.4 The government could have required the Canada Post Corporation to respond under the *Financial Administration Act*

89. (1) The Governor in Council may, on the recommendation of the appropriate Minister, give a directive to any parent Crown corporation, if the Governor in Council is of the opinion that it is in the public interest to do so.

(2) Before a directive is given to a parent Crown corporation, the appropriate Minister shall consult the board of directors of the corporation with respect to the content and effect of the directive.

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

7.44 To date, the government has not asserted its legal power to direct the Canada Post Corporation to provide information in response to Question 37 or other order paper questions. Privy Council Office officials indicated that the Canada Post Corporation has used the "commercial sensitivity of information" as a way of not fully responding to order paper questions for a long time. They also indicated that it was a long standing practice of the House to not question the use of commercial sensitivity as a valid reason not to provide certain type of information. In tasking questions and dealing with proposed answers, the Privy Council Office has indicated that it is guided by the practices of the House and the speakers' rulings. For that reason, the Canada Post Corporation's response to Question 37, given that it was consistent with established practice, was found to be acceptable by the Privy Council Office.

7.45 We noted that the Privy Council Office has not clarified under what circumstances the government would exercise its authority to insist that a Crown corporation provide information in its response. In our opinion when the government determines it will not require a Crown corporation to provide the requested information, the nature of the commercial sensitivity should be disclosed.

7.46 The Canadian Wheat Board, like the Canada Post Corporation, indicated in its response that the information requested was commercially sensitive. However, in its response, the Board did provide supplementary information on the number of tonnes of wheat shipped, the approximate shipping costs per tonne, and the relative share of shipping services that The CSL Group Inc. had provided for the Canadian Wheat Board. With this information the Privy Council Office was able to provide the member of Parliament with an estimate of amounts paid to the holdings of The CSL Group Inc.

Shared governance corporation—An entity without share capital for which Canada, either directly or through a Crown corporation, has a right to appoint or nominate one or more members to its board of directors.

7.47 **Port authorities were not asked to respond.** Based on a long standing practice adopted by the Privy Council Office, it did not ask 18 port authorities to respond in the second round of Question 37 because they are shared governance corporations. Privy Council Office officials indicated that unless the member of Parliament specifically requests information from shared governance corporations, it does not ask them to respond to order paper questions. We noted that Privy Council Office has indicated that it does not consider these organizations part of government, based on the legal interpretation of the term "agency of government." In our opinion, based on the review of the enabling legislation and on the fact the government itself treats these corporations as part of government in the Public Accounts of Canada and in other areas, the port authorities are agencies of the government, and therefore, they should have been tasked with responding to the question.

7.48 We have therefore concluded that, except for the effect of the above noted practices, the process that the Privy Council Office used was sufficient for the response to Order Paper Question 37 provided on 28 January 2004 to be reasonably complete with respect to grants, contributions, and contracts from the government. We cannot quantify the effect on the government's response of the practice of not seeking information from all relevant organizations. In addition, the response did not include a loan guarantee of $10 million.

Adequacy of reforms

7.49 As a result of the problems relating to the first response to Question 37, the government announced reforms for dealing with order paper questions. The reforms appeared at the same time as the second response to Question 37 was released. The departments received the new instructions on 2 March 2004. As part of this audit, we were asked to assess whether the proposed reforms would result in adequate information for parliamentarians. To carry out this assessment, we

- analyzed underlying reasons why the first response to Question 37 was incomplete,

- audited four other order paper questions to compare the process before and after the reforms, and
- assessed the adequacy of the reforms announced.

The first response to Question 37 demonstrated a need for reforms

7.50 In the months following the tabling of the first response, its accuracy was questioned. We analyzed the first response in order to be able to comment on whether the reforms announced by the government address the underlying reasons why the first response was incomplete.

7.51 We noted that the Privy Council Office did not consider the changes to the corporate structure of The CSL Group Inc. when preparing instructions for the departments. The Privy Council Office used the list of assets contained in the 2002 public declaration rather than a list of all companies that had been added and/or removed over the 10-year period covered by Question 37. As a result, departments and agencies searched their information systems for the names of only 50 companies rather than the names of all 84 companies. The effect of this was to understate the amount of the contracts in the first response by $6.3 million.

7.52 For the first response, only 10 of the departments and 16 agencies and Crown corporations were asked to provide a response to Question 37. The actual assignment of the question to the entities was based on the Privy Council Office's assessment of whether or not that particular entity might have had dealings with companies listed in the public declaration provided by the former Office of the Ethics Counsellor.

7.53 Another factor that contributed to an incomplete response was the unclear instructions issued by the Privy Council Office to departments. Public Works and Government Services Canada had prepared information on all contracts that it had entered into on behalf of other departments. When asking the Privy Council Office for clarification, Public Works and Government Services Canada was instructed to provide information only on the contracts that were issued for its own departmental requirements. Accordingly, Public Works and Government Services Canada's response did not include contracts amounting to $36.7 million for the contracts it entered into on behalf of other government departments. The evidence that we have seen indicates that Public Works and Government Services Canada's interpretation of the instructions was reasonable.

7.54 We found that, when submitting its response to the Privy Council Office, one department had interpreted its instructions in the same way that Public Works and Government Services Canada had. It indicated that it had included only contracts that it had issued directly and had excluded contracts that Public Works and Government Services Canada had issued on its behalf. A careful review of these responses should have caused the Privy Council Office to question the completeness of the responses and to initiate corrective action before the responses were tabled in the House of Commons.

7.55 We also examined the process for completing the public declaration of declarable assets. The former Office of the Ethics Counsellor used incomplete information to prepare the public declaration of declarable assets. The CSL Group Inc. compiled a list of companies and forwarded it to the supervisor of the blind management agreement who has indicated that he relied on the information provided to him by The CSL Group Inc. He then submitted the list to the former Ethics Counsellor, who, in turn, used it to prepare the public declaration. We found, and the government acknowledges, that the 2002 declaration had omitted one company in which The CSL Group Inc. held a minority interest. This company had received contracts from the federal government. The effect of this omission was to understate the amount of the contracts in the first response by $20.4 million. We also noted that another company was omitted from the 2002 public declaration. That company had not received any grants, contracts, or loan guarantees from the government.

7.56 We noted that the process for completing the public declaration of declarable assets did not require either the corporate officers of the companies managed by this agreement or the supervisor of the agreement to certify that the information that they provided to the former Office of the Ethics Counsellor was, indeed, accurate and complete. There should be a requirement for the supervisor of a blind management agreement and corporate officers of the companies managed by such an agreement to certify the completeness, integrity, and accuracy of the information contained in the public declaration of declarable assets.

7.57 Since the initial response to Question 37, the House of Commons amended the *Parliament of Canada Act* to provide for the appointment of a new Ethics Commissioner, who replaces the former Ethics Counsellor.

7.58 **Difference between first and second responses.** The first response to Question 37 was tabled on 14 February 2003 and indicated that an amount of $137,250 was received by companies listed in the public declaration of the former minister of Finance. The second response, which was tabled on 6 February 2004, indicated that $161,811,926 was received by companies on a revised list that included declarable assets over the 10-year period. The difference between the first and the second response is explained in Exhibit 7.5.

Common deficiencies in the process to respond to order paper questions

7.59 To assess whether the reforms would result in accurate information for parliamentarians we audited four other written order paper questions shown in Exhibit 7.6 to compare the process before and after the reforms. Two questions pre-dated 2 March 2004, that is, when departments first received the new instructions, and two arose after that date. Our criteria for choosing each of the four questions were as follows:

- the question required a response from several entities, and
- the question was financial in nature.

Exhibit 7.5 Difference between the first response and the second response ($ millions)

First response tabled on 14 February 2003	
Included contracts with companies held by The CSL Group Inc. between April 1993 and October 2002 (used fiscal year)	0.1
Amounts not taken into account in the first response	
Different time period used for the second response: • added one trimester (January 1993 to March 1993), which resulted in an additional amount of $62.1 million • added one additional year (November 2002 to October 2003), which resulted in an additional amount of $25.2 million	87.3
Confusion between the Privy Council Office and Public Works and Government Services Canada about including contracts entered into on behalf of other departments	36.7
Contracts given to one of two companies that had been omitted by error from the 2002 public declaration of declarable assets	20.4
Contracts given to companies that had been included in the holdings of The CSL Group Inc. at some time between 1993 and 2002, but that had been disposed of, before the 2002 public declaration of assets was prepared	6.3
Contracts awarded using division names instead of company names and therefore, not searched by departments.	4.4
Privy Council Office listed contracts twice and included one contract that was awarded outside the scope of the question	6.6
Second response tabled 6 February 2004	**$161.8**

About 30 percent of all written order paper questions in the 37th Parliament required a response from more than one entity; of those, over 50 percent were financial in nature.

7.60 These criteria enabled us to compare the responses to the questions to assess whether the reforms announced are sufficient (Exhibit 7.7). We recognize that the reforms are new and have not yet been fully implemented.

7.61 **The revised instructions have not yet translated into more complete responses.** In examining the four questions in Exhibit 7.6, we found that the responses to these questions showed continuing deficiencies. All four were incomplete, and we have concluded that the revised instructions have not dealt with the underlying causes of the incomplete responses. These common deficiencies in the process used to respond to order paper questions are summarized in Exhibit 7.8.

7.62 **Key terms not defined by the Privy Council Office.** When key terms are not defined, this may create confusion that may result in members of Parliament not always getting the information that they requested. All four questions requested financial information about funding from the government. Some members of Parliament may not be aware that the Privy

Council Office interprets the term "government" to mean only departments and agencies, and that it does not include Crown corporations. Similarly, asking for information by fiscal year or calendar year can result in significantly different answers. As well, the term "contract" may be interpreted differently. A contract usually includes the acquisition of goods and services, but could be extended to include goods acquired with acquisition cards.

7.63 The initial and subsequent responses to Question 37 illustrate that, by not specifying whether information is being requested by fiscal or calendar year, the response can vary significantly. The initial response to Question 37 provided information on the basis of the government's fiscal year: the second response provided it on a calendar year basis. This resulted in a difference of approximately $62.1 million (see Exhibit 7.5).

Exhibit 7.6 Other order paper questions we audited

Tabled before the 2 March 2004 reforms

Question 73 (1st Session)

"With regard to grants, contributions and/or loan guarantees made either by a Crown corporation, a department and/or an agency of the government to General Motors in Sainte-Thérèse, Quebec, for each fiscal year since 1965: (a) how many such grants, contributions and/or loan guarantees were made; (b) what was the source and value of each grant, contribution and/or loan guarantee; (c) on what dates were they issued; (d) what was the reason such assistance was provided; and (e) what is the present status of the grant, contribution and/or loan guarantee (whether repaid, partially paid, or unpaid, including the value of the repayment)?"

Question 186 (2nd Session)

"Concerning contracts: (a) what is the total value of contracts made annually by the government since 1993 broken down by province and territory; (b) what is the total value of contracts made annually by department, agency, and/or crown corporation since 1993; (c) what are the top ten contracts in value for each year since 1993 (please provide the name of the recipient, location, and the value of the contract); (d) for the last five years, what are the top five lawsuits on an annual basis against the government over contractual disputes and what was each dispute about; (e) for the last five years, what are the top ten contracts awarded to companies outside of Canada and what were those contracts for?"

Tabled after the 2 March 2004 reforms

Question 56 (3rd Session)

"With regard to the Southern Chiefs' Organization in Manitoba, how much and what type of funding has the government provided, for each fiscal year since the organization's inception?"

Question 78 (3rd Session)

"What funds, grants, loans and loan guarantees has the federal government issued in the constituency of Dartmouth for each of the fiscal years 1999-2000, 2000-2001, 2001-2002, 2002-2003; and, in each case where applicable: (a) what was the department or agency responsible, (b) what was the program under which the payment was made, (c) what were the names of the recipients, groups or organizations, (d) what was the monetary value of the payment made, and (e) what was the percentage of program funding covered by the payment received?"

Exhibit 7.7 Changes to the response process for order paper questions after the reforms

Before the reforms	After the reforms
Privy Council Office	
Practice of designating a lead department to review government-wide response is not in place.	If additional co-ordination is required, the Privy Council Office designates a lead department to review and validate responses to complex or horizontal questions. If no department has been designated as lead department, then the Privy Council Office ensures co-ordination.
Departments, agencies, and Crown corporations	
Departments do not have a designated signing officer.	Departments appoint a designated senior official to sign off on responses.
There is no practice in place for a lead department.	Lead department is designated for complex or horizontal questions. Lead department reviews government-wide responses.
There is no statement of completeness that indicates if response is complete and accurate.	Designated senior official signs a statement of completeness that certifies response is complete and accurate. The statement of completeness briefly describes how the research was conducted and the steps taken to ensure that the response is complete and accurate.
There is no ministerial signature for "nil" responses.	The minister's or parliamentary secretary's signature is required for all responses including nil responses. They should sign after the statement of completeness has been signed by the designated senior official.
The parliamentary returns officer sends response to the Privy Council Office in the required time.	The parliamentary returns officer sends response and statement of completeness to the Privy Council Office in the required time.

Exhibit 7.8 Common deficiencies in responses to the four written order paper questions—Before and after the reforms

	Before the reforms		After the reforms	
	Question 73	Question 186	Question 56	Question 78
Key terms not defined		●	●	●
Question not properly assigned to all departments, agencies, and Crown corporations			●	
Lack of appropriate level of care by departments in searching for information	●	●		●
Failure of organizations to provide requested information in their responses		●	●	●

7.64 **Incomplete tasking of the question by the Privy Council Office.** Incomplete tasking occurs when the Privy Council Office does not request a response from a government organization that should have been "tasked" or included on the list of government entities asked to respond to an order paper question.

7.65 The Privy Council Office tasked some departments to respond to Question 56. Because the question dealt with funding for an Aboriginal organization, we would have expected Indian and Northern Affairs Canada to have been designated as the lead department. The announced reforms allow the Privy Council Office to designate a lead department to review responses to complex questions or questions with horizontal issues. However, the Privy Council Office did not task Indian and Northern Affairs Canada with the role of a lead department.

7.66 Order Paper Question 56 asks how much and what type of funding the "government" provided to the Southern Chiefs' Organization. As previously mentioned, the Privy Council Office interprets the word "government" as excluding Crown corporations. In our opinion, one Crown corporation in particular—Canada Mortgage and Housing Corporation—should have been asked to respond to Question 56. It would have been reasonable for the Privy Council Office to have included the Canada Mortgage and Housing Corporation because it provides funding to First Nations organizations for capacity development and other purposes. When we spoke to the Canada Mortgage and Housing Corporation, it agreed that it would have been reasonable for Canada Mortgage and Housing Corporation to have been asked to respond to Question 56. It also indicated that it had not provided any funding to the Southern Chiefs' Organization.

7.67 In our view, the Privy Council Office's failure to task the Canada Mortgage and Housing Corporation illustrates the lack of a broad, corporate understanding of which organizations might reasonably be expected to operate programs in specific areas. Within an organization the size and the complexity of the government, this is a difficult task. Nevertheless, we believe that the Privy Council Office is not exercising an appropriate level of care in identifying all relevant government organizations to ensure that responses to questions are complete.

7.68 **Lack of appropriate level of care by some departments in searching for information.** Sometimes entities that are asked to respond to an order paper question do not rigorously search all relevant data sources when developing their answers. This can lead to omissions.

7.69 The response to Question 73 submitted in 2001 illustrated this weakness. Human Resources Development Canada was one of the entities asked to respond to Question 73 (effective December 2003 the Department was divided into two departments—Human Resources and Skills Development Canada and Social Development Canada). The Department indicated that it had not contributed any funding to a General Motors plant in Ste-Thérèse, Québec, since 1965. By searching the Public Accounts of Canada, we found that Human Resources Development Canada had not included in its response over $4 million paid between 1981 and 1992 by Employment and Immigration Canada, one of the departments amalgamated to form Human Resources Development Canada in 1996.

7.70 Human Resources Development Canada searched its records for the period covered by the government's record retention policy. For the period outside the record retention policy, Human Resources and Development Canada did not use publicly available information in its response to Question 73.

7.71 We noted in our audit that for order paper questions that are financial in nature, departments and agencies did not always search information that is publicly available, such as the Public Accounts of Canada and estimates. These documents represent a good source of information, and departments and agencies need to refer to them when preparing responses.

7.72 **Failure of organizations to provide the requested information in their responses.** The response to Question 78 illustrates the failure of some departments and agencies to provide any information in their responses to order paper questions that require very specific information. Order Paper Question 78 is significant because it is typical of the questions that many members of Parliament ask. Such questions enable them to find out what government funding has flowed to their constituencies. Generally, departments do not keep records of their expenditures by individual constituency. We note that many departments did not provide any information in their responses to Question 78. They indicated that they did not compile data on a riding-by-riding basis.

7.73 However, in an effort to respond to Question 78, one department tasked with answering the question traced their funds by using the postal codes of recipients to whom they had sent cheques. These postal codes correlate closely with the boundaries of ridings. This technique may not provide a perfect answer because the mailing address of the recipient may not always indicate the location where the actual work was completed. However, using postal codes represents an attempt on the part of the department to be responsive to the member of Parliament's need for information. In our view, the department that did respond made an effort to provide an appropriate level of service to members of Parliament.

7.74 The response to Question 186, which requested information on government-contracting activity, also illustrates an incomplete response because not all departments, agencies, and Crown corporations responded to all parts of the question. The significant information that was generally missing involved the section that referred to the breakdown of the value of contracts by province. We also noted that because of a clerical error, the response of one agency that was provided to the Privy Council Office, was not included in the response tabled in the House. As with other responses examined, the response for Question 186 did not contain a summary that consolidated the individual responses of all departments. The task of consolidating more than 800 pages of information was left to the member of Parliament who asked the question.

7.75 **The Privy Council Office's revised instructions represent a first step toward improving responses to questions.** The revised instructions from the Privy Council Office to departments, agencies, and Crown corporations largely focussed on having a stronger process for reviewing responses at the departmental level and requiring sign-offs or certifications about the completeness and accuracy of departments' responses. For example, the Privy Council Office may designate a lead department to review and validate responses to complex questions involving a number of government organizations. We have been advised by officials of the Privy Council Office that this initiative reflects their historic role of co-ordinating responses to questions and the need for the Privy Council Office to present to members of Parliament data that has been received from departments and agencies in an unmodified form. The new instructions also require a senior official of each organization that responds to a question to sign a "statement of completeness." The statement certifies that the information in the response is complete and accurate. The statement also briefly describes the scope of the research that the organization carried out in developing the response. In signing the statement of completeness, the senior official certifies that staff have thoroughly searched all relevant records. Ultimately, a minister or parliamentary secretary must also sign off on all departmental responses (including nil responses).

7.76 In our audit, we assessed the adequacy of the reforms announced. Designating a lead department to review responses to complex multi-departmental questions could be applicable but only in a limited number of circumstances. The staff of a department may not have sufficient knowledge about a subject area in which several other departments are involved. We found that the reforms do not indicate what the expectations of the lead department are and what level of responsibility the Privy Council Office has delegated to the lead department. If the Privy Council Office designates a lead department, the Office will need to ensure that the department has the capacity to discharge this responsibility and that it has sufficient government or program-wide knowledge to exercise an appropriate level of care in reviewing the responses before they are tabled.

7.77 In the revised instructions, the Privy Council Office provided departments, agencies, and Crown corporations with an example of a statement of completeness that should be prepared for each response to an order paper question. The statement, which includes a description of the research carried out, states "As designated senior official responsible for providing a response to parliamentary question no. XX for (Department), I attest that, based on a thorough review of relevant records, the information attached is accurate and complete." The statement accompanies the response when it is sent to the appropriate minister or parliamentary secretary for signature. Once the reply is signed, both the response and the statement are sent to the Privy Council Office. Before the Privy Council Office can carry out its quality control review of the responses, it must receive all the statements of completeness. We noted that in the two responses that we audited for the period after the reforms were announced, about 13 percent of the statements of completeness that the Privy Council Office received did not describe the scope of work that the department carried out to develop its response to the order paper question.

7.78 The intent of the statements is to establish who will be held accountable for the response. The person attesting to the information will implicitly be attesting, for example, to

- the adequacy of the design of internal controls around information systems used to develop the response,
- the effectiveness of the controls throughout the period covered by the question, and
- the integrity and completeness of the information contained in the systems.

Each statement should also clearly state any limitations to the work completed in developing a response. The overall level of expectation resulting from the attestation of information will entail additional demands on departments in responding to questions. It may also require them to commit additional resources to the process.

7.79 We note that the reforms were only recently implemented and that the Privy Council Office is still in the process of getting organized to fulfill its responsibilities.

Strengthening the process for responding

7.80 When the government issued its revised instructions for responding to order paper questions, it recognized that it might have to take further steps to reform the process. Accordingly, our Office was asked to recommend any additional steps that might be needed to ensure that questions receive accurate and complete answers.

7.81 We compared and analyzed the Canadian process for responding to written order paper questions with the process used in the United Kingdom (Exhibit 7.9). It is important to note that written questions in the United Kingdom are generally one sentence in length and seek general information from only one government department or agency.

7.82 In our view, if the government is to improve the quality of responses to order paper questions, it will need to strengthen more than those measures provided for in the announced reforms. The additional measures needed are to

- clarify the terminology used in the question to ensure more relevant, useful responses;
- provide a member of Parliament with contextual information and indicate any limitations in preparing the response;
- obtain full responses from all relevant Crown corporations;
- strengthen departmental search procedures;
- present the responses in an aggregated format that is more informative to members of Parliament; and
- update the Privy Council Office's process for tracking questions and responses.

Exhibit 7.9 Process for responding to written order paper questions in Canada and the United Kingdom—A comparison

Process	Canada	United Kingdom
Compliance with parliamentary procedures	The Clerk of the House ensures that questions are placed on the Notice Paper, according to the rules of the House.	The Table Office receives questions. The clerks advise on how to have them conform with the rules of the House.
Questions are assigned to entities	The Office of the Co-ordinator of Parliamentary Returns in Privy Council Office assigns questions to entities.	The Table Office in Parliament assigns the questions (but questions may be transferred by ministers from one government department to another).
Guidance is given to entities	The Privy Council Office offers clarifications if a department asks.	The Cabinet Office offers advice to departments on multi-departmental questions, to be used at the department's discretion.
Certification of responses and scope of work	Since the reforms, departments send a statement of completeness describing work done to the Privy Council Office. A senior official signs the statement certifying that it is complete and accurate. The Minister or parliamentary secretary must sign responses including nil responses.	Senior official, in charge of program or activity, is responsible for completeness and accuracy of responses. Responses often include a good description of work performed to respond to question.
Responses tabled	Parliamentary secretary of the Leader of the Government in the House tables responses in the House.	Responses are delivered to members of Parliament with copies to the Library, the Table Office, the Official Report, and the Press Gallery. They are printed within days in Hansard.
No replies	A department, agency, or Crown corporation can indicate that it cannot answer the question.	Departments can decline to respond to information, citing an exemption in the Code of Practice on Access to Government Information or disproportionate cost.
Recourse if members of Parliament are not satisfied	If a questions remains unanswered at the end of 45 days (if requested) it is referred to the relevant standing committee. The subject matter can also be raised in the adjournment proceedings. No provisions for Speaker to review responses. However, members of Parliament can raise questions of privilege regarding accuracy of responses. Speaker has ruled that it is not his role to assess accuracy of answer.	Members of Parliament can raise concerns in the House: point of order, adjournment debate, or Early Day Motion. They can contact the Table Office, Procedure Committee, or the Public Administration Select Committee, which reports on Ministerial Accountability and Parliamentary Questions. Some members have complained to the Parliament Ombudsman after being refused an answer by reference to an exemption in the Code of Practice on Access to Government Information.
Procedures for incorrect answer	It is possible to supply supplementary replies to questions already answered.	If a written answer contains factually inaccurate information, ministers may send a second written answer "pursuant" to the first, correcting the original answer. Departments must clear such pursuant answers with the Table Office in advance.
Limit of questions that a member of Parliament can ask	Four questions on the Order Paper at any given time.	No limit.

Exhibit 7.9 Process for responding to written order paper questions in Canada and the United Kingdom—A comparison (cont'd)

Process	Canada	United Kingdom
Time limit to respond	Members of Parliament can request a response in 45 calendar days.	"Named Day" questions must receive response by the date specified by the member of Parliament. There is no parliamentary rule stating that ordinary questions have to be answered by a certain date. The convention is that responses can be expected in about a working week.
Number of order paper questions	1st Session (29 January 2001 to 16 September 2002): **192** questions	6 December 2000 to 11 May 2001: **16,417** questions
	2nd Session (30 September 2002 to 12 November 2003): **296** questions	13 June 2001 to 7 November 2002: **72,905** questions
	3rd Session (2 February 2004 to 23 May 2004): **98** questions	13 November 2002 to 20 November 2003: **55,436** questions

Common understanding of terminology needed

7.83 Members of Parliament who submit questions must adhere to a number of rules and guidelines, as already noted. In 1995, the Speaker indicated that a member of Parliament who submits a question is responsible for ensuring " . . . that it is formulated carefully enough to elicit the precise information sought." To do this we believe members of Parliament need additional clarification to help them frame questions in a way that will produce a more accurate response. Examples of terminology that require clarification include

- Key terms such as "government" (including definitions of a department, an agency, a Crown corporation, a mixed corporation, and a shared governance corporation), "funds," and "money" so that members of Parliament can judge how the Privy Council Office will interpret their questions and determine the information to include in the responses.
- The distinction between calendar and fiscal years (as we have noted, using a calendar year can produce an answer very different from that developed using a fiscal year).
- The difference between information on the "value of contracts awarded", and on the "amount actually paid out under the contracts."

7.84 A glossary of terms would result in the members of Parliament being able to formulate clearer questions that would be less open to misinterpretation. The Privy Council Office could also use this glossary of terms in asking organizations to respond and in preparing instructions for departments, agencies, and Crown corporations to help them interpret the question. This would result in less confusion and in responses providing the precise information sought.

7.85 **Recommendation.** The Clerk of the Privy Council, in concert with the Clerk of the House, should develop and distribute a glossary of terms for use by members of Parliament in writing their order paper questions.

The government's response. The government agrees with the recommendation and is working with the Clerk of the House to define a list of commonly used terms. The Clerk of the House will determine the most appropriate method to bring these definitions to the attention of the House.

More contextual information would improve the quality of responses

7.86 We noted that responses to order paper questions do not contain certain information that would make them more useful to members of Parliament. Currently, the Privy Council Office does not provide members of Parliament with the same instructions it gives to the departments to prepare responses. These instructions cover key areas such as which department or agency was tasked with responding to the question and any limitations encountered by the government in developing a response. Similarly, the Privy Council Office should provide the members of Parliament with information on the scope of work carried out by each department preparing a response. If members of Parliament had access to this information, they could detect any omissions or misinterpretations relating to their questions. Reducing the potential for omissions or misinterpretation should lead to more complete responses that better meet the needs of parliamentarians.

7.87 **Recommendation.** To help members of Parliament assess whether a response to their question is satisfactory, the Privy Council Office should provide an appendix to the response showing the instructions that it sent to departments and the scope of work departments did to answer the question.

The government's response. The government agrees with this recommendation and is consulting the Office of the Speaker of the House of Commons to determine what the appropriate way is to include the appendix of instructions that were provided to departments in the overall government response.

Responses would be more complete with information from relevant Crown corporations

7.88 As noted earlier, the Privy Council Office has not clarified under what circumstances the government would exercise its authority to require that a Crown corporation to provide relevant information in its response to order paper questions.

7.89 **Recommendation.** The Privy Council Office should clarify circumstances for which the government will compel Crown corporations to provide the information sought in their responses to order paper questions.

The government's response. The government agrees with this recommendation and will revise policies to specify, under what circumstances, Crown corporations can or should be compelled to provide information of a commercially sensitive nature in response to order paper questions.

Strengthening departmental search procedures

7.90 As previously noted, there is a need for departments to strengthen their procedures for developing a response to order paper questions that are financial in nature. We noted that departments search their electronic information systems for the period covered by the government's record retention policy. However, we have noted instances where departments have not included in their procedures a review of key departmental financial reports, which contained relevant information.

7.91 **Recommendation.** For order paper questions that are financial in nature, departments' procedures for developing responses should include a search of existing, publicly available financial documents for relevant information.

The government's response. The government agrees with this recommendation, and instructions have been sent to all departments, agencies and Crown corporations to ensure this measure is in place by January 2005.

Presenting responses in an aggregated format that is more informative to members of Parliament

7.92 For complex order paper questions that seek financial information, the responses can also be complex. Question 37 is a good illustration of that. We believe there is a role for the Privy Council Office to ensure that the designated lead department aggregates the data prepared by departments before it is tabled. In our opinion, this would better serve members of Parliament.

7.93 **Recommendation.** For order paper questions that seek financial information, the Privy Council Office should ensure that the designated lead department aggregates the data provided by departments before tabling the response.

The government's response. The government agrees with this recommendation. The designated lead department for each order paper question will be formally asked to aggregate, to the extent possible, complex financial data prior to the information being tabled in the House.

The process for tracking questions and responses is outdated

7.94 The current system that the Privy Council Office uses to track questions and responses is largely manual. It relies on faxes and courier services to move information between its office and the departments that are developing responses to order paper questions. The existing system causes needless delays and does not make use of current technologies that could speed up the process. The Privy Council Office uses a manual process to track the status of responses to questions. It is based on phone calls and faxes. While this process does provide information on the status of a response, it is slow and cumbersome and leaves less time to develop the response.

7.95 **Recommendation.** The Privy Council Office should automate the tracking of responses to order paper questions to improve the efficiency of the process.

The government's response. The Privy Council Office agrees with this recommendation and has taken steps to modernize its processes and systems. A technical analysis has been completed and a scope of work developed to implement proposed changes. The Privy Council Office will complete its project plan by January 2005.

A stronger process is needed for the Ethics Commissioner to complete the public declaration of declarable assets

7.96 We have noted the process for creating the public declaration of declarable assets does not require anyone to certify that the information is accurate and complete. In our opinion, the supervisor of a blind management agreement should be required to provide such a certification.

7.97 **Recommendation.** The Ethics Commissioner should require the supervisor of a blind management agreement to certify that the information used to produce the public declaration of declarable assets is complete and accurate.

The government's response. The government agrees with this recommendation and has addressed it. On 7 October 2004 the Prime Minister issued a revised Conflict of Interest and Post-Employment Code for Public Office Holders. Subsection 7(6) has been added to require that public office holders who have established either trusts or management agreements must require their trustees or managers to provide a written annual report to the Ethics Commissioner that verifies as to the accuracy, the nature and market value of the subject property, a reconciliation at the subject property, the net income of the subject property in the preceding year, and the fees of the trustees or managers, if any. In addition, the "Schedule" to the Code, which sets out more detailed provisions regarding trusts and management agreements, has been revised to make reference to this obligation.

The Ethics Commissioner's response. The Office of the Ethics Commissioner agrees with the recommendation.

Sustained effort needed

7.98 The importance of questions to ministers in the parliamentary system cannot be overemphasized. Sustained effort is needed to ensure that the reforms to the process for responding to order paper questions that the government announced in January 2004 are fully implemented. It is also essential that the responsibility be assigned for ensuring that the recommendations be implemented. We believe that this could be a role for the internal audit unit of the Privy Council Office. The internal auditors are in a position to assess the extent to which the improvements have led to providing members of Parliament with the information they need to hold the government accountable.

7.99 **Recommendation.** The internal audit unit at the Privy Council Office should conduct an audit and report on whether the reforms announced by the government and the recommendations made in this report are fully implemented.

The government's response. The Privy Council Office agrees with this recommendation and will ensure that an audit on the implementation of the reforms is completed.

Conclusion

7.100 The right of a member of Parliament to seek information from ministers and to hold them accountable are two fundamental principles of parliamentary government. The audit work that we have performed on five order paper questions has led us to conclude that, other than for the second response to Question 37, a greater level of care is needed in responding to order paper questions. For members of Parliament to effectively discharge their responsibilities, it is essential that they receive full and complete responses to their questions.

7.101 In Parliamentary tradition, the matter of whether the answer provided by the government to a member's question is satisfactory is a parliamentary judgment that only members and ultimately the House can make. In preparing the second response to Order Paper Question 37, the Privy Council Office exercised considerable oversight to ensure that the responses from departments were complete. In our opinion, the process, except for the effect of the practice noted below, was sufficient for the response to Order Paper Question 37 on 28 January 2004 to be reasonably complete with respect to grants, contributions, and contracts from the government. The effect of the practice of not tasking all organizations to provide a response on amounts of grants, contributions, contracts, and loan guarantees with holdings listed in the public declaration cannot been quantified. While in our opinion port authorities should have been tasked with responding to Question 37, the Privy Council Office does not, based on their legal interpretation of the term "agency of government", consider port authorities to be part of government. The response also did not include a loan guarantee of $10 million.

7.102 We recognize that the government has taken positive steps to strengthen the process for preparing responses to order paper questions. Our audit has identified further actions that the government should take.

7.103 The government should address the recommendations set out in this report to strengthen the process that supports the fundamental cornerstone of our parliamentary system of government—the right of members of Parliament to receive the necessary information to hold ministers and the government to account.

The government's overall response. The government is very pleased to note that the Auditor General has found

- the response to Order Paper Question 37 that was tabled in the House of Commons on 28 January 2004 is reasonably complete,
- the timeframe selected to respond to Question 37 is the most inclusive possible, and

- great care and considerable oversight was exercised to ensure the response to Question 37 was complete and that reforms to the order paper question response process that were put in place in January 2004 are positive initiatives.

The Auditor General noted that the government response did not include the government's guarantee of a $10 million loan by a commercial bank to Canarctic Shipping Limited, a company in which the Government of Canada was the majority shareholder and in which Canada Steamship Lines (CSL) held a minority interest as part of a consortium of shipping companies. It is further noted that the Government of Canada was not required to make any payments in connection with this guarantee. With respect to this transaction, the government would reinforce the following points:

- The loan guarantee was awarded in June 1993 by the previous government and thus prior to when the former minister of Finance first entered into the Cabinet, therefore before the establishment of any blind management agreement.
- The loan guarantee was operational from 1993 to 1996 when the Government of Canada sold its interests in Canarctic Shipping Limited. Since the government was not required to make payments in connection with the loan guarantee, and since The CSL Group Inc. divested itself of its minority share in 1994, the value of the loan guarantee to CSL, if it could be calculated, was negligible.

The Government of Canada fully accepts all of the recommendations included in Chapter 7 of the Auditor General's Report and has implemented or is implementing all of them.

The Government of Canada did not ask the 18 Canada Port Authorities, which do not depend on taxes for revenue and do not, as a part of their normal business, provide funding to shipping companies, to respond to Question 37. The Auditor General's Report notes that the port authorities should have been asked to respond, but indicates there is a difference of legal interpretation on this issue (that is, the Government of Canada is of the view that the phrase "agency of government" as used in the context of Question 37 does not include Canada Port Authorities.) This issue will be addressed as part of the Government of Canada's commitment to implement the first recommendation.

About the Audit

Objectives

The audit objectives were to determine whether

- the process followed for the second response to Order Paper Question 37 was sufficient to provide a reasonably complete response to Parliament, based on the information that the government possessed and given the inherent limitations of those systems;
- the proposed reforms to the handling of order paper questions are sufficient to ensure complete information is provided to parliamentarians and are applied consistently; and
- other steps could be undertaken to better the process to respond to written questions.

Scope and approach

The focus of our audit was to assess whether the government's response to Question 37 provided on 28 January 2004 was complete. To assess the adequacy of the reforms announced by the government we selected two other order paper questions answered before the government's reforms were announced to document and test the process followed at that time. We also selected two order paper questions that members of Parliament asked after 2 March 2004, the date on which the government's reforms were to be implemented, to test whether the reforms were working as intended.

We performed detailed audit procedures as necessary in the following departments: Public Works and Government Services Canada (including Consulting and Audit Canada), National Defence, Transport Canada, Fisheries and Oceans Canada, Atlantic Canada Opportunities Agency, Industry Canada, the Canadian Space Agency, and the Canada Economic Development Agency for the Quebec Regions.

We performed audit procedures in selected Crown corporations aimed at detecting possible additional transactions.

We examined the process leading to the public declaration of assets of the former Minister of Finance and how it was monitored by the previous Office of the Ethics Counsellor. We did not audit the completeness of the list of holdings in the blind management agreement of the former minister of Finance because this information related to privately held companies. Auditing such information is outside the mandate of the Auditor General of Canada.

Given the limitations to the government systems, the period covered by the question (10 years) and the policy on records retention, it was not feasible for the government or for us to provide an assurance about whether the answer to Order Paper Question 37 was complete. We examined the process that was followed to respond to Question 37 to determine whether the government provided a reasonably complete response to Parliament based on the information that the government possessed and given the inherent limitations of those systems. The audit did not include the contracting process followed for the contracts awarded to the holdings of the blind management agreement; nor did it include the use of sub-contracts.

Criteria

We expected the Privy Council Office to

- assess and mitigate the risks associated with responding to Question 37;
- ensure that order paper questions were properly assigned to each department, agency and Crown corporation, in a timely manner;
- provide instructions to assist departments, agencies, and Crown corporations interpret order paper questions in a consistent manner; and
- exercise due diligence in analysing the responses to order paper questions to ensure their completeness, accuracy, and reasonableness in the circumstance.

We expected the departments, agencies, and Crown corporations to

- have reasonable procedures and systems in place that produce reliable, accurate, and timely information that allows them to respond to order paper questions;
- have substantiated the responses to order paper questions with complete, accurate, and timely information;
- have clearly defined the responsibility for approving the responses to parliamentary questions; and
- assess and mitigate the risks associated with responding to written questions.

We expected the former Office of the Ethics Counsellor to

- formally approve the blind management agreement and confirm it to the public office holder; and
- exercise due diligence in reviewing the public office holder's confidential report for accuracy and compliance arrangements (to the Code), on an annual basis.

We expected the supervisor of the blind management agreement, on behalf of the public office holder, to

- have clearly defined role and responsibilities, with respect to the public disclosure of declarable assets of the public office holder;
- certify the completeness and accuracy of the public office holder's public disclosure of declarable assets.

The sources of criteria for this audit are the Parliamentary Returns Guide, past rulings made by the Speaker of the House, the House procedures, Part II of the Conflict of Interest and Post-Employment Code for Public Office Holders (June 1994), and practices in other jurisdictions.

Audit team

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Report of the Auditor General of Canada to the House of Commons—November 2004

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2004

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NOVEMBER

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Office of the Auditor General of Canada

The November 2004 Report of the Auditor General of Canada comprises eight chapters, Matters of Special Importance—2004, and Main Points. The main table of contents is found at the end of this publication.

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Chapter

8

Other Audit Observations

All of the audit work in this chapter was conducted in accordance with the standards for assurance engagements set by the Canadian Institute of Chartered Accountants. While the Office adopts these standards as the minimum requirement for our audits, we also draw upon the standards and practices of other disciplines.

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Other Audit Observations

Main Points

8.1 This chapter fulfills a special role in the Report. Other chapters normally report on performance audits or on audits and studies that relate to operations of the government as a whole. Other Audit Observations discusses specific matters that have come to our attention during our financial and compliance audits of the Public Accounts of Canada, Crown corporations, and other entities, or during our performance audits or audit work to follow up on third-party complaints. Because these observations deal with specific matters, they should not be applied to other related issues or used as a basis for drawing conclusions about matters not examined.

8.2 This chapter covers one new issue:

- Telefilm Canada—The majority of the activities of Telefilm Canada are not consistent with its Act.

8.3 The Standing Committee on Public Accounts has requested that we continue to bring to Parliament's attention previous observations that have not been resolved. In this Report, we follow up on two of these observations:

- The surplus in the Employment Insurance Account—Non-compliance with the intent of the *Employment Insurance Act*;
- Parc Downsview Park Inc.—Unresolved issues related to the transfer of Downsview lands and the financing of Downsview Park's future operations.

The surplus in the Employment Insurance Account

Non-compliance with the intent of the *Employment Insurance Act*

In brief

We have drawn Parliament's attention to the concerns about the size and the growth of the accumulated surplus in the Employment Insurance Account since our 1999 Report. The accumulated surplus has increased by $2 billion, to reach $46 billion in 2003–04. In our view, Parliament did not intend for the Account to accumulate a surplus beyond what could reasonably be spent for employment insurance purposes, given the existing benefit structure and allowing for an economic downturn. In our opinion, the government has not observed the intent of the *Employment Insurance Act*. In 2003, the government announced that it would conduct consultations on a new rate-setting process and would introduce legislation to implement a new process for 2005. In the 2004 Budget, the government noted that it was reviewing the results of the consultations and still planned to introduce legislation for 2005. However, the government has yet to address the concerns about the accumulated surplus in the Employment Insurance Account.

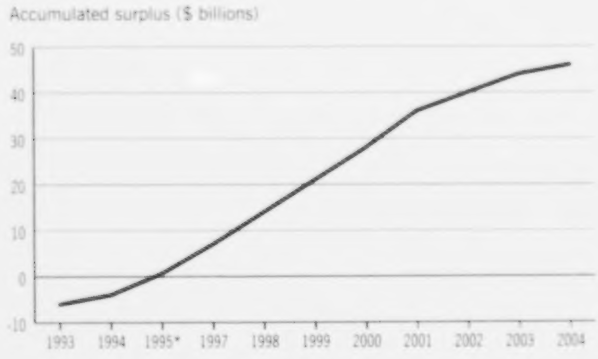
Audit objective

8.4 Our objective was to determine whether the government had addressed the concerns we had raised in previous years and to report on the progress achieved.

Background

8.5 The surplus in the Employment Insurance Account grew by $2 billion to reach $46 billion in 2003–04. Exhibit 8.1 shows the growth of the accumulated surplus. For the last five years we have drawn Parliament's attention to this issue in our reports on the Employment Insurance Account's financial statements and in the Public Accounts of Canada.

Exhibit 8.1 Balance of the Employment Insurance Account



* For a period of 15 months

Source: Audited financial statements of the Employment Insurance Account

Issues

8.6 The *Employment Insurance Act* requires that an account be established, in the accounts of Canada, for employment insurance revenues and expenditures. There have been many discussions about what the balance in the Employment Insurance Account represents. We have used terms like "notional account" and "tracking account" to describe the balance, because funds received in the form of premiums are deposited in the government's Consolidated Revenue Fund and not in a separate bank account. The EI Account balance provides a basis for managing the Account, and has been an important factor in setting premium rates.

8.7 Section 66 of the *Employment Insurance Act* requires that, to the extent possible, the premium rate be set to provide enough revenue over a business cycle to pay amounts authorized to be charged to the Account, while maintaining relatively stable rates. In our view, this means that employment insurance premiums should equal expenditures over the same period of time and provide sufficient reserve to keep rates stable in an economic downturn. We believe Parliament's intent was that the program would operate on a break-even basis over the course of a business cycle. The legislation also made it necessary for the Canada Employment Insurance Commission to make certain key decisions—such as how it would define "business cycle" and "relatively stable rates."

8.8 In May 2001, the Act was amended to suspend section 66 for 2002 and 2003 and to give the Governor-in-Council the authority to set the rates for those two years. The rate for 2004 was set in the Act in accordance with the 2003 Budget legislation, and section 66 was further suspended. The rates for 2002, 2003, and 2004 were set respectively at \$2.20, \$2.10, and \$1.98 per \$100 of insurable earnings.

8.9 The *Employment Insurance Act* provides that all money collected for employment insurance purposes be credited to the Account. The only authorized amounts that can be charged to the Account are employment insurance benefits and administration costs. In our view, Parliament did not intend for the Account to accumulate a surplus beyond what could reasonably be spent for employment insurance purposes. In his 2001 report, the Chief Actuary of Human Resources Development Canada estimated that a maximum reserve of \$15 billion was sufficient. Since section 66 of the *Employment Insurance Act* was suspended, the Commission has not requested another report. The current surplus now exceeds three times the maximum reserve considered sufficient by the Chief Actuary. Accordingly, we believe the government has not observed the intent of the *Employment Insurance Act*.

8.10 In the 2003 Budget, the government announced that it would conduct consultations on a new rate-setting process and would introduce legislation to implement a process for establishing the 2005 rate. In the 2004 Budget, the government noted that it was reviewing the results of the consultations and still planned to introduce legislation for 2005. Also, by suspending section 66 again, it gave the Governor-in-Council the authority to set the rate for 2005 should legislation not be passed in time. Even after public consultations, there has been no progress on resolving this issue.

8.11 In the 2003 and 2004 budgets, the government described the principles for its new premium-rate-setting process:

- Rates should be set transparently and on the basis of independent expert advice.
- Expected premium revenues should correspond to expected program costs.
- Rates should mitigate the impact on the business cycle and be stable over time.

8.12 The principles are consistent with those in section 66 of the Act. They are also consistent with our interpretation that Parliament's intent was for the Employment Insurance Program to run on a break-even basis over time. The principles may ensure that the surplus does not grow significantly once a new rate-setting process is in place. However, they do not address the $46 billion surplus that has accumulated.

8.13 The 2004 EI premium rate was set in the 2003 Budget on the basis of economic forecasts and the principles noted above—in particular, that the rates would generate premium revenues equal to projected program costs. However, premium revenues do not include interest revenues. With an accumulated surplus that exceeds $46 billion, interest revenues will continue to contribute significantly to the surplus. In 2003–04, interest revenues added about $1 billion to the operating surplus.

Conclusion

8.14 Even after public consultations, the government has yet to address the concerns about the surplus in the Employment Insurance Account. In May 2001, section 66 of the *Employment Insurance Act* was suspended for two years. In the 2003 and 2004 budgets, the government announced that it would have legislation for a new rate-setting process in place for 2005. Three years after the suspension of section 66, legislation has yet to be introduced.

8.15 In our view, Parliament did not intend for the Account to accumulate a surplus beyond what could reasonably be spent for employment insurance purposes, given the existing benefit structure and allowing for an economic downturn. In our opinion, the government has not observed the intent of the *Employment Insurance Act*.

The government's comments. The government believes that the setting of the Employment Insurance premium rates has been consistent with the applicable legislation. For 2001 and prior, under Bill C-111, the Canada Employment Insurance Commission, which is independent of the government, set the Employment Insurance premium rates and not the government. With respect to Employment Insurance rate setting for 2002, 2003, 2004, and 2005, Parliament approved legislation that gave the government the authority to set premium rates for these years.

There has been considerable confusion about the rate-setting process. This was first highlighted in the 1999 Report of the Standing Committee on Finance. In the 2003 Budget, the government launched formal consultations on a new rate-setting mechanism based on a number of principles. These principles were reiterated in the 2004 Budget and provided the basis for the setting of the premium rates in 2004. The government remains committed to these principles in the setting of premium rates.

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Parc Downsview Park Inc.

Unresolved issues related to the transfer of Downsview lands and the financing of Downsview Park's future operations

In brief

We have reported annually for the last four years that the Government of Canada has not requested—and accordingly Parliament has not provided—clear and explicit authority to create and operate an urban park, an initiative that Parc Downsview Park Inc. has undertaken. Furthermore, Parliament has not authorized the related spending of public funds. The government met applicable legal and administrative requirements in establishing Downsview Park. However, the individual steps taken together had the effect of leaving Parliament out of the decision-making process.

We have also commented on shortcomings in the corporate structure adopted for the Downsview Park initiative. In 2003, we reported that the government took steps to address certain issues that we and the Public Accounts Committee had previously raised about the Park. Although it did not request Parliament's clear and explicit authority to create and operate the Park, the government has deemed Downsview Park to be a parent Crown corporation that will report to Parliament through the responsible minister. The government also took steps to remedy shortcomings in the structure of Downsview Park.

However, the government has not yet resolved the issues related to the transfer of Downsview lands from National Defence to Downsview Park and to the financing of the Park's future operations. Although no formal appraisals were done, the portion of the land designated for commercial development was estimated to be worth over $100 million in 2001. Downsview Park's ability to fulfill its mandate to develop and operate an urban park on a self-financing basis depends on the resolution of these issues.

Audit objective

8.16 Our objective was to determine the progress the government had made in addressing our remaining concerns about the transfer of Downsview lands and the future funding of Downsview Park.

Background

8.17 Downsview Park was established following the closure of the Canadian Forces Base in Toronto announced in the government's 1994 Budget, although the only reference the Budget made to Downsview Park was a reference to the National Defence budget impact paper. That paper indicated, "[the] Downsview site will be held in perpetuity and in trust primarily as a unique urban recreational green space for the enjoyment of future generations."

8.18 In November 1995 the government approved, in principle, the use of about 600 acres of Downsview land for development of the park based on the following principles:

- the retention of more than one-half of the site as parkland;

- the ability to be "self-financing" from sources outside federal appropriations, including the ability to raise limited debt from the private sector;
- the capability to raise and retain other qualifying revenues and to form corporate relationships with third parties for this purpose;
- operation based on a "trust concept," recognizing the special nature of these lands; and
- accommodation of a continuing military presence.

8.19 In April 1997, the government issued an order-in-council authorizing Canada Lands Company Limited (Canada Lands), a non-agent Crown corporation, to set up a subsidiary corporation that would develop an urban, recreational, green space on a self-financing basis for the enjoyment of future generations. Canada Lands incorporated Parc Downsview Park Inc. as a wholly-owned subsidiary Crown corporation in July 1998.

8.20 On 15 August 2000, pursuant to the authority granted under an order-in-council, Downsview Park acquired about 32 acres of land from National Defence in exchange for a $19 million promissory note payable in 2050, bearing no interest and subordinated to all other debts of Downsview Park. In September 2000, it sold the land to a private sector company; the sale proceeds were deposited in its bank account and have been used primarily to fund the operations of Downsview Park. In effect, the government has indirectly transferred $19 million in cash to Downsview Park to fund its activities.

8.21 **Our previous observations.** We have reported annually since October 2000 that the government has not requested—and accordingly Parliament has not provided—clear and explicit authority to create and operate an urban park, an initiative that Downsview Park has undertaken. Furthermore, Parliament has not authorized the related spending of public funds. The government met legal and administrative requirements in establishing Downsview Park. However, the individual steps taken together had the effect of leaving Parliament out of the decision-making process. We have also commented on shortcomings in the corporate structure adopted for Downsview Park.

8.22 The House of Commons Standing Committee on Public Accounts held hearings on this matter in 2002 and made five recommendations, among them that the Privy Council Office seek parliamentary approval to make Downsview Park, a parent Crown corporation. In response, the government noted that the creation of Downsview Park had met all legal requirements and followed appropriate authorities.

8.23 However, on 3 September 2003, the government took action to address our concerns and those of the Public Accounts Committee. It deemed Downsview Park a parent Crown corporation directly accountable to Parliament through the responsible minister.

8.24 On 16 September 2003, a royal proclamation converted Downsview Park from a non-agent to an agent Crown corporation with certain privileges normally enjoyed by the Crown, including eligibility to receive donations from the private sector.

8.25 In our November 2003 Report we concluded that these actions had addressed the issues we had raised about Downsview Park's accountability to Parliament and the shortcomings in its corporate structure.

Issues

8.26 Although the government has addressed some of the issues we raised in our previous reports, there are still unresolved issues. These relate to the transfer of Downsview lands from National Defence to Downsview Park and to the financing of the future development and operations of the Park. Although no formal appraisals were done, the portion of the land designated for commercial development was estimated to be worth over $100 million in 2001. To date, the government has made no final decisions on these issues.

8.27 Having become an agent Crown corporation, Downsview Park entered into a memorandum of understanding (MOU) with National Defence, an interim operating arrangement as of 16 September 2003. Under the MOU, Downsview Park acts effectively as a property manager for National Defence and is paid management fees. This arrangement is to continue until the Downsview lands are transferred to Downsview Park.

8.28 The Corporate Plan for the period 2003-04 to 2007-08, which Downsview Park submitted when it became a "deemed" parent Crown corporation, was approved by the Governor-in-Council only for the 2003-04 planning period. The Corporate Plan for the period 2004–05 to 2008–09 is still being finalized.

8.29 The uncertainties arising from the unresolved land transfer issues and funding arrangements limit Downsview Park's ability to achieve its core mandate. Its Board of Directors has stated that the organization's ability to fulfill its mandate depends on resolving these issues. Meanwhile, Downsview Park continues to incur operating costs. At 31 March 2004, about $8 million out of the $19 million it obtained from the sale of a parcel of land in 2000 had been used to fund its activities.

Conclusion

8.30 The transfer of Downsview lands from National Defence to Downsview Park and the financing of the organization's future operations are issues that need to be resolved if Downsview Park is to fulfill its mandate to create and operate an urban park on a self-financing basis.

Infrastructure Canada's comments. Infrastructure Canada officials will continue to work with central agencies, officials at Parc Downsview Park Inc., and National Defence to find a mechanism to enable the transfer of Downsview lands from National Defence to Parc Downsview Park Inc. The transfer of the Downsview lands is a necessary first step to ensure that the Corporation can finance the future development of Downsview Park.

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Telefilm Canada

The majority of the activities of Telefilm Canada are not consistent with its Act

In brief

The mission of Telefilm Canada, as stated in the *Telefilm Canada Act*, is to foster and promote the development of the feature film industry in Canada. However, since 1967 when the original Act was adopted, the government has extended the Corporation's activities to include the television, new media, and music sectors, with memoranda of understanding and contribution agreements with Canadian Heritage. The majority of the Corporation's expenses are for these new activities.

Telefilm Canada's role and responsibilities have expanded to other industries, while its Act still limits it to the development of the feature film industry. In our opinion, the Corporation's activities in supporting the development of the television, new media, and music industries are not consistent with its legal mandate. If the government intends to have Telefilm Canada support these industries, it needs to reflect this in the Act.

Audit objective

8.31 Our objective was to determine whether the activities of Telefilm Canada, which came to our attention during our audit of its financial statements, conform in all significant respects with the *Telefilm Canada Act* and the by-laws of the Corporation.

Background

The activities of Telefilm Canada have evolved

8.32 In 1967 the *Canadian Film Development Corporation Act* (in June 2002 it became the *Telefilm Canada Act*) created the Canadian Film Development Corporation. The Act stipulates that the Corporation is "to foster and promote the development of a feature film industry in Canada." To this end, the Corporation may

- invest in individual Canadian feature film productions in return for a share in the proceeds from any such production;
- make loans to producers of individual Canadian feature film productions and charge interest;
- award outstanding accomplishments in the production of Canadian feature films;
- provide grants to filmmakers and film technicians who reside in Canada to assist them in improving their craft;
- advise and assist Canadian feature film producers in the distribution of their films and the administration of feature film production; and
- guarantee loans for the production and distribution of films, following an amendment to the Act in 1994.

8.33 From 1968 to 1983, the Corporation focussed on the production and development of Canadian feature films. By the mid 1970s, its annual investments were $3 million to $4 million. In 1982–83, its parliamentary appropriation totalled $4.5 million.

8.34 From 1983 to 2004, the federal government increased, in a significant way, the activities of the Corporation (in 2002 it became officially Telefilm Canada). In response to changes in technology, the needs of the industry, and the cultural objectives of the government, the Department of Communications (which ceased operating in 1993), and then Canadian Heritage created funds and programs in the following sectors: feature film, television, new media, and music. The management of these funds and programs was entrusted to Telefilm. It receives additional funding through annual parliamentary appropriation and through contributions from Canadian Heritage. Memoranda of understanding and contribution agreements confirm Telefilm Canada's additional responsibilities, the government's objectives, and the amount of contributions accorded to the Corporation. In addition, they set out the terms and conditions of the new funds and programs and specify the administrative and accountability frameworks required by the Department. Exhibit 8.2 lists the Corporation's activities from 1967 to 2001.

Exhibit 8.2 The Corporation's activities from 1967 to 2001

1967	The Canadian Film Development Corporation was created (it became officially Telefilm Canada in 2002) to foster the development of a feature film industry by assisting the private sector with the production of feature films.
1983	The Canadian Broadcast Development Fund was created to finance part of the cost of planning, developing, and producing Canadian television productions in the following categories: drama, variety, children's programming, and documentaries.
1986	The Feature Film Fund was created to finance scripts, project development, and feature film launches in cinemas, and to grant long-term loans to Canadian distribution and foreign sales companies.
	The Versioning Assistance Fund was created to finance the dubbing and subtitling of Canadian and foreign film and television productions that are distributed in Canada.
1988	The Feature Film Distribution Fund was created to assist Canadian film distributors buy the distribution rights of Canadian feature films destined for Canadian and foreign cinemas and assist them in corporate development and marketing initiatives.
1996	The Canada Television and Cable Production Fund was created (it became the Canadian Television Fund in 1998). Telefilm administers one of the fund's two programs: the Equity Investment Program. This program, a continuation of the 1983 Canadian Broadcast Development Fund, pursues the same objectives and activities.

Exhibit 8.2 The Corporation's activities from 1967 to 2001 (cont'd)

1998	The Multimedia Fund (it became the Canada New Media Fund in 2001) was created to finance the development, production, and marketing of multimedia works, and the growth and development of a Canadian multimedia production and distribution industry that is competitive in international markets.
2000	The Canada Feature Film Fund combines the Feature Film Fund, the Versioning Assistance Fund, and the Feature Film Distribution Fund. It finances similar activities as the initial funds.
2001	The Music Entrepreneur Program was created; it consists of two components. It finances the development or update of a five-year business plan, which will further the objectives of the Program, and it assists with the implementation of such business plans.

8.35 The new programs and additional funding allow Telefilm Canada to finance the different stages of a feature film and television production, specifically script development, production, and distribution and promotion in Canada and abroad. Also, the Corporation can finance the development, production, and marketing of new media products. It can support the music industry with financial assistance to organizations in this sector. For 2003–04, federal funding to the Corporation totalled $199 million, which included a parliamentary appropriation of $128 million and contributions of $71 million from Canadian Heritage.

Issues

The majority of commitments are for activities other than feature films

8.36 The majority of Telefilm Canada's commitments lie in developing the television, new media, and music industries. Exhibit 8.3 shows that these commitments represent 62 percent of all the commitments of the last three fiscal years.

Exhibit 8.3 Annual commitments by sector from 2001–02 to 2003–04 ($ millions)

Year	Feature film	Other activities			Total
		Television	New media	Music	
2001–02	61.6	111.3	10.1	-	183
2002–03	84.4	117.5	6.1	4.5	212.5
2003–04	91.4	115.9	9.5	8.7	225.5
Total	**237.4**	**344.7**	**25.7**	**13.2**	**621**
	38%	**56%**	**4%**	**2%**	**100%**

Source: Telefilm Canada, annual reports 2001–02 to 2003–04

8.37 In order to fulfill its initial mandate and additional responsibilities, Telefilm Canada receives financing from the following sources:

- A parliamentary appropriation, approved annually by Parliament and defined as "Payments to Telefilm Canada to be used for the purposes set out in the *Telefilm Canada Act.*" This appropriation finances the feature film sector and part of the activities of the television sector.
- Contributions from Canadian Heritage finance part of the activities of the television sector and all the activities of the new media and music sectors.
- Revenues from the recovery on investments, which must be reinvested in the same sector as the initial investment.
- Contributions from a private non-profit organization finance part of the activities of the television sector.

The parliamentary appropriations and the contributions from Canadian Heritage represent 53 percent and 30 percent of the Corporation's total financing, from 2001 to 2004.

Initiatives to amend the Act

8.38 Over the past years, a number of reports recommended that the government review the Act and clarify the Corporation's mandate. They included the Report of the Task Force on Program Review (Nielsen Report) in 1985; the Report of the Task Force on Broadcasting Policy (Caplan/Sauvageau Report) in 1986; the Report of the Standing Committee on Communications and Culture in 1988; and the Report of the Mandate Review Committee of the Canadian Broadcasting Corporation, the National Film Board and of Telefilm Canada (Juneau Report) in 1996. More recently, the Report of the Standing Committee on Canadian Heritage (Lincoln Report), published in June 2003, also discusses the necessity to clarify the mandate of various cultural organizations including Telefilm Canada.

8.39 During our audit, we found documents, from 1986 and earlier, on initiatives to adopt, among other things, a generic term to describe the Corporation's mandate such as "cultural industries" that would cover the television, new media, and music sectors. Also, since 2001, Canadian Heritage and Telefilm Canada's Board of Directors have discussed the mandate of the Corporation and changes to the Act. Nevertheless, these initiatives and discussions did not lead to a proposal for draft legislation.

8.40 We were informed that in 2003 Telefilm Canada and Canadian Heritage started reviewing the *Telefilm Canada Act* to reflect the current operational context of the Corporation, the powers granted to it, and the principles of modern governance.

The Telefilm Canada Act was not amended

8.41 Over the years, the activities of Telefilm Canada were expanded without an amendment to its Act. Instead, the government entered into contribution agreements for Telefilm's other activities that were not in feature films.

8.42 Our Office expressed concern, to Telefilm Canada's management and Audit and Finance Committee, that the Corporation's activities have been expanded while its legal mandate has not been brought up to date. We also noted the efforts made to address these concerns. In 2004, in our audit report on Telefilm Canada's financial statements, we issued a reservation on the compliance of its activities with the *Telefilm Canada Act*. In our opinion, the activities for developing the television, new media, and music industries are not consistent with the mandate of the Corporation.

Conclusion

8.43 In its annual report and financial statements, Telefilm Canada clearly describes its activities and presents the expenses for each sector separately. However, the activities in the television, new media, and music industries are not consistent with its mandate—to develop the feature film industry.

8.44 If the government intends Telefilm Canada to support the development of the television, new media, and music industries, it needs to review the *Telefilm Canada Act* and have the necessary modifications passed by Parliament.

8.45 **Recommendation.** The government should clarify the mandate and powers that it wants Telefilm Canada to have, update the *Telefilm Canada Act* to reflect the changes, and obtain parliamentary approval.

Canadian Heritage's response. Canadian Heritage is currently in the process of putting forward proposals to address the situation.

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Appendix A *Auditor General Act*

R.S.C., c. A-17
An Act respecting the Office of the Auditor General of Canada and sustainable development monitoring and reporting
1995, c. 43, s.1.

Short Title

Short title **1.** This Act may be cited as the *Auditor General Act*. 1976-77, c. 34, s.1.

Interpretation

Definitions **2.** In this Act,

"appropriate Minister" "appropriate Minister" has the meaning assigned by section 2 of the *Financial Administration Act*;

"Auditor General" "Auditor General" means the Auditor General of Canada appointed pursuant to subsection 3(1);

"category I department" "category I department" means

(a) any department named in Schedule I to the *Financial Administration Act*,

(b) any department in respect of which a direction has been made under subsection 24(3), and

(c) any department set out in the schedule;

"Commissioner" "Commissioner" means the Commissioner of the Environment and Sustainable Development appointed under subsection 15.1(1);

"Crown corporation" "Crown corporation" has the meaning assigned to that expression by section 83 of the *Financial Administration Act*;

"department" "department" has the meaning assigned to that term by section 2 of the *Financial Administration Act*;

"registrar" "registrar" means the Bank of Canada and a registrar appointed under Part IV of the *Financial Administration Act*;

"sustainable development" "sustainable development" means development that meets the needs of the present without compromising the ability of future generations to meet their own needs;

"sustainable development strategy" "sustainable development strategy", with respect to a category I department, means the department's objectives, and plans of action, to further sustainable development. 1976-77, c. 34, s. 2; 1984, c. 31, s. 14; 1995, c. 43, s. 2.

Auditor General of Canada

Appointment and tenure of office **3.** (1) The Governor in Council shall, by commission under the Great Seal, appoint a qualified auditor to be the officer called the Auditor General of Canada to hold office during good behaviour for a term of ten years, but the Auditor General may be removed by the Governor in Council on address of the Senate and House of Commons.

Idem (2) Notwithstanding subsection (1), the Auditor General ceases to hold office on attaining the age of sixty-five years.

Re-appointment (3) Once having served as the Auditor General, a person is not eligible for re-appointment to that office.

Vacancy (4) In the event of the absence or incapacity of the Auditor General or if the office of Auditor General is vacant, the Governor in Council may appoint a person temporarily to perform the duties of Auditor General. 1976-77, c. 34, s. 3.

Salary

4. (1) The Auditor General shall be paid a salary equal to the salary of a puisne judge of the Supreme Court of Canada.

Pension benefits

(2) The provisions of the *Public Service Superannuation Act*, other than those relating to tenure of office, apply to the Auditor General except that a person appointed as Auditor General from outside the Public Service may, by notice in writing given to the President of the Treasury Board not more than sixty days after the date of his appointment as Auditor General, elect to participate in the pension plan provided for in the *Diplomatic Service (Special) Superannuation Act* in which case the provisions of that Act, other than those relating to tenure of office, apply to him and the provisions of the *Public Service Superannuation Act* do not apply to him. 1976–77, c. 34, s. 4; 1980–81–82–83, c. 50, s. 23, c. 55, s. 1.

Duties

Examination

5. The Auditor General is the auditor of the accounts of Canada, including those relating to the Consolidated Revenue Fund and as such shall make such examinations and inquiries as he considers necessary to enable him to report as required by this Act. 1976–77, c. 34, s. 5.

Idem

6. The Auditor General shall examine the several financial statements required by section 64 of the *Financial Administration Act* to be included in the Public Accounts, and any other statement that the President of the Treasury Board or the Minister of Finance may present for audit and shall express his opinion as to whether they present fairly information in accordance with stated accounting policies of the federal government and on a basis consistent with that of the preceding year together with any reservations he may have. 1976–77, c. 34, s. 6; 1980–81–82–83, c. 170, s. 25.

Annual and additional reports to the House of Commons

7. (1) The Auditor General shall report annually to the House of Commons and may make, in addition to any special report made under subsection 8(1) or 19(2) and the Commissioner's report under subsection 23(2), not more than three additional reports in any year to the House of Commons

- (a) on the work of his office; and,
- (b) on whether, in carrying on the work of his office, he received all the information and explanations he required.

Idem

(2) Each report of the Auditor General under subsection (1) shall call attention to anything that he considers to be of significance and of a nature that should be brought to the attention of the House of Commons, including any cases in which he has observed that

- (a) accounts have not been faithfully and properly maintained or public money has not been fully accounted for or paid, where so required by law, into the Consolidated Revenue Fund;
- (b) essential records have not been maintained or the rules and procedures applied have been insufficient to safeguard and control public property, to secure an effective check on the assessment, collection and proper allocation of the revenue and to ensure that expenditures have been made only as authorized;
- (c) money has been expended other than for purposes for which it was appropriated by Parliament;
- (d) money has been expended without due regard to economy or efficiency;
- (e) satisfactory procedures have not been established to measure and report the effectiveness of programs, where such procedures could appropriately and reasonably be implemented; or
- (f) money has been expended without due regard to the environmental effects of those expenditures in the context of sustainable development.

Submission of annual report to Speaker and tabling in the House of Commons

(3) Each annual report by the Auditor General to the House of Commons shall be submitted to the Speaker of the House of Commons on or before December 31 in the year to which the report relates and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it.

Notice of additional reports to Speaker and tabling in the House of Commons

(4) Where the Auditor General proposes to make an additional report under subsection (1), the Auditor General shall send written notice to the Speaker of the House of Commons of the subject-matter of the proposed report.

Submission of additional reports to Speaker and tabling in the House of Commons

(5) Each additional report of the Auditor General to the House of Commons made under subsection (1) shall be submitted to the House of Commons on the expiration of thirty days after the notice is sent pursuant to subsection (4) or any longer period that is specified in the notice and the Speaker of the House of Commons shall lay each such report before the House of Commons forthwith after receiving it or, if that House is not then sitting, on any of the first fifteen days on which that House is sitting after the Speaker receives it. 1976–77, c. 34, s. 7; 1994, c. 32, s. 1 and 2; 1995, c. 43, s. 3.

Special report to the House of Commons

8. (1) The Auditor General may make a special report to the House of Commons on any matter of pressing importance or urgency that, in the opinion of the Auditor General, should not be deferred until the presentation of the next report under subsection 7(1).

Submission of reports to Speaker and tabling in the House of Commons

(2) Each special report of the Auditor General to the House of Commons made under subsection (1) or 19(2) shall be submitted to the Speaker of the House of Commons and shall be laid before the House of Commons by the Speaker of the House of Commons forthwith after receipt thereof by him, or if that House is not then sitting, on the first day next thereafter that the House of Commons is sitting. 1976–77, c. 34, s. 8; 1994, c. 32, s. 3.

Idem

9. The Auditor General shall

(a) make such examination of the accounts and records of each registrar as he deems necessary, and such other examinations of a registrar's transactions as the Minister of Finance may require, and

(b) when and to the extent required by the Minister of Finance, participate in the destruction of any redeemed or cancelled securities or unissued reserves of securities authorized to be destroyed under the *Financial Administration Act*,

and he may, by arrangement with a registrar, maintain custody and control, jointly with that registrar, of cancelled and unissued securities. 1976–77, c. 34, s. 9.

Improper retention of public money

10. Whenever it appears to the Auditor General that any public money has been improperly retained by any person, he shall forthwith report the circumstances of the case to the President of the Treasury Board. 1976–77, c. 34, s.10.

Inquiry and report

11. The Auditor General may, if in his opinion such an assignment does not interfere with his primary responsibilities, whenever the Governor in Council so requests, inquire into and report on any matter relating to the financial affairs of Canada or to public property or inquire into and report on any person or organization that has received financial aid from the Government of Canada or in respect of which financial aid from the Government of Canada is sought. 1976–77, c. 34, s. 11.

Advisory powers

12. The Auditor General may advise appropriate officers and employees in the public service of Canada of matters discovered in his examinations and, in particular, may draw any such matter to the attention of officers and employees engaged in the conduct of the business of the Treasury Board. 1976–77, c. 34, s. 12.

Access to Information

Access to information

13. (1) Except as provided by any other Act of Parliament that expressly refers to this subsection, the Auditor General is entitled to free access at all convenient times to information that relates to the fulfilment of his responsibilities and he is also entitled to require and receive from members of the public service of Canada such information, reports and explanations as he deems necessary for that purpose.

Stationing of officers in departments

(2) In order to carry out his duties more effectively, the Auditor General may station in any department any person employed in his office, and the department shall provide the necessary office accommodation for any person so stationed.

Oath of secrecy

(3) The Auditor General shall require every person employed in his office who is to examine the accounts of a department or of a Crown corporation pursuant to this Act to comply with any security requirements applicable to, and to take any oath of secrecy required to be taken by, persons employed in that department or Crown corporation.

Inquiries

(4) The Auditor General may examine any person on oath on any matter pertaining to any account subject to audit by him and for the purposes of any such examination the Auditor General may exercise all the powers of a commissioner under Part I of the *Inquiries Act*. 1976–77, c. 34, s.13.

Reliance on audit reports of Crown corporations

14. (1) Notwithstanding subsections (2) and (3), in order to fulfil his responsibilities as the auditor of the accounts of Canada, the Auditor General may rely on the report of the duly appointed auditor of a Crown corporation or of any subsidiary of a Crown corporation.

Auditor General may request information

(2) The Auditor General may request a Crown corporation to obtain and furnish to him such information and explanations from its present or former directors, officers, employees, agents and auditors or those of any of its subsidiaries as are, in his opinion, necessary to enable him to fulfil his responsibilities as the auditor of the accounts of Canada.

Direction of the Governor in Council

(3) If, in the opinion of the Auditor General, a Crown corporation, in response to a request made under subsection (2), fails to provide any or sufficient information or explanations, he may so advise the Governor in Council, who may thereupon direct the officers of the corporation to furnish the Auditor General with such information and explanations and to give him access to those records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries access to which is, in the opinion of the Auditor General, necessary for him to fulfil his responsibilities as the auditor of the accounts of Canada. 1976–77, c. 34, s. 14.

Staff of the Auditor General

Officers, etc.

15. (1) Such officers and employees as are necessary to enable the Auditor General to perform his duties shall be appointed in accordance with the *Public Service Employment Act*.

Contract for professional services

(2) Subject to any other Act of Parliament or regulations made thereunder, but without the approval of the Treasury Board, the Auditor General may, within the total dollar limitations established for his office in appropriation Acts, contract for professional services.

Delegation to Auditor General

(3) The Auditor General may exercise and perform, in such manner and subject to such terms and conditions as the Public Service Commission directs, the powers, duties and functions of the Public Service Commission under the *Public Service Employment Act*, other than the powers, duties and functions of the Commission in relation to appeals under section 21 of that Act and inquiries under section 34 of that Act.

Suspension

(4) The Auditor General may suspend from the performance of his duty any person employed in his office. 1976–77, c. 34, s. 15; 1992, c. 54, s. 79.

Appointment of Commissioner

15.1 (1) The Auditor General shall, in accordance with the *Public Service Employment Act*, appoint a senior officer to be called the Commissioner of the Environment and Sustainable Development who shall report directly to the Auditor General.

Commissioner's duties

(2) The Commissioner shall assist the Auditor General in performing the duties of the Auditor General set out in this Act that relate to the environment and sustainable development. 1995, c. 43, s. 4.

Responsibility for personnel management

16. In respect of persons employed in his office, the Auditor General is authorized to exercise the powers and perform the duties and functions of the Treasury Board under the *Financial Administration Act* that relate to personnel management including the determination of terms and conditions of employment and the responsibility for employer and employee relations, within the meaning of paragraph 7(1)(e) and sections 11 to 13 of that Act. 1976–77, c. 34, s.16.

Classification standards

17. Classification standards may be prepared for persons employed in the office of the Auditor General to conform with the classifications that the Auditor General recognizes for the purposes of that office. 1976–77, c. 34, s. 18.

Delegation

18. The Auditor General may designate a senior member of his staff to sign on his behalf any opinion that he is required to give and any report, other than his annual report on the financial statements of Canada made pursuant to section 64 of the *Financial Administration Act* and his reports to the House of Commons under this Act, and any member so signing an opinion or report shall indicate beneath his signature his position in the office of the Auditor General and the fact that he is signing on behalf of the Auditor General. 1976–77, c. 34, s. 19.

Estimates

Estimates

19. (1) The Auditor General shall annually prepare an estimate of the sums that will be required to be provided by Parliament for the payment of the salaries, allowances and expenses of his office during the next ensuing fiscal year.

Special report

(2) The Auditor General may make a special report to the House of Commons in the event that amounts provided for his office in the estimates submitted to Parliament are, in his opinion, inadequate to enable him to fulfil the responsibilities of his office. 1976–77, c. 34, s. 20.

Appropriation allotments

20. The provisions of the *Financial Administration Act* with respect to the division of appropriations into allotments do not apply in respect of appropriations for the office of the Auditor General. 1976–77, c. 34, s. 21.

Audit of the Office of the Auditor General

Audit of the office of the Auditor General

21. (1) A qualified auditor nominated by the Treasury Board shall examine the receipts and disbursements of the office of the Auditor General and shall report annually the outcome of his examinations to the House of Commons.

Submission of reports and tabling

(2) Each report referred to in subsection (1) shall be submitted to the President of the Treasury Board on or before the 31st day of December in the year to which the report relates and the President of the Treasury Board shall lay each such report before the House of Commons within fifteen days after receipt thereof by him or, if that House is not then sitting, on any of the first fifteen days next thereafter that the House of Commons is sitting. 1976–77, c. 34, s. 22.

Sustainable Development

Purpose

21.1 The purpose of the Commissioner is to provide sustainable development monitoring and reporting on the progress of category I departments towards sustainable development, which is a continually evolving concept based on the integration of social, economic and environmental concerns, and which may be achieved by, among other things,

(a) the integration of the environment and the economy;
(b) protecting the health of Canadians;
(c) protecting ecosystems;
(d) meeting international obligations;
(e) promoting equity;
(f) an integrated approach to planning and making decisions that takes into account the environmental and natural resource costs of different economic options and the economic costs of different environmental and natural resource options;
(g) preventing pollution; and
(h) respect for nature and the needs of future generations. 1995, c. 43, s. 5.

Petitions received

22. (1) Where the Auditor General receives a petition in writing from a resident of Canada about an environmental matter in the context of sustainable development that is the responsibility of a category I department, the Auditor General shall make a record of the petition and forward the petition within fifteen days after the day on which it is received to the appropriate Minister for the department.

Acknowledgement to be sent

(2) Within fifteen days after the day on which the Minister receives the petition from the Auditor General, the Minister shall send to the person who made the petition an acknowledgement of receipt of the petition and shall send a copy of the acknowledgement to the Auditor General.

Minister to respond

(3) The Minister shall consider the petition and send to the person who made it a reply that responds to it, and shall send a copy of the reply to the Auditor General, within

- (a) one hundred and twenty days after the day on which the Minister receives the petition from the Auditor General; or
- (b) any longer time, where the Minister personally, within those one hundred and twenty days, notifies the person who made the petition that it is not possible to reply within those one hundred and twenty days and sends a copy of that notification to the Auditor General.

Multiple petitioners

(4) Where the petition is from more that one person, it is sufficient for the Minister to send the acknowledgement and reply, and the notification, if any, to one or more of the petitioners rather than to all of them. 1995, c. 43, s. 5.

Duty to monitor

23. (1) The Commissioner shall make any examinations and inquiries that the Commissioner considers necessary in order to monitor

- (a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before the House of Commons under section 24; and
- (b) the replies by Ministers required by subsection 22(3).

Commissioner's report

(2) The Commissioner shall, on behalf of the Auditor General, report annually to the House of Commons concerning anything that the Commissioner considers should be brought to the attention of that House in relation to environmental and other aspects of sustainable development, including

- (a) the extent to which category I departments have met the objectives, and implemented the plans, set out in their sustainable development strategies laid before that House under section 24;
- (b) the number of petitions recorded as required by subsection 22(1), the subject-matter of the petitions and their status; and
- (c) the exercising of the authority of the Governor in Council under any of subsections 24(3) to (5).

Submission and tabling of report

(3) The report required by subsection (2) shall be submitted to the Speaker of the House of Commons and shall be laid before that House by the Speaker on any of the next fifteen days on which that House is sitting after the Speaker receives it. 1995, c. 43, s. 5.

Strategies to be tabled

24. (1) The appropriate Minister for each category I department shall cause the department to prepare a sustainable development strategy for the department and shall cause the strategy to be laid before the House of Commons

- (a) within two years after this subsection comes into force; or
- (b) in the case of a department that becomes a category I department on a day after this subsection comes into force, before the earlier of the second anniversary of that day and a day fixed by the Governor in Council pursuant to subsection (4).

Updated strategies to be tabled

(2) The appropriate Minister for the category I department shall cause the department's sustainable development strategy to be updated at least every three years and shall cause each updated strategy to be laid before the House of Commons on any of the next fifteen days on which that House is sitting after the strategy is updated.

Governor in Council direction

(3) The Governor in Council may, on that recommendation of the appropriate Minister for a department not named in Schedule I to the *Financial Administration Act*, direct that the requirements of subsections (1) and (2) apply in respect of the department.

Date fixed by Governor in Council

(4) On the recommendation of the appropriate Minister for a department that becomes a category I department after this subsection comes into force, the Governor in Council may, for the purpose of subsection (1), fix the day before which the sustainable development strategy of the department shall be laid before the House of Commons.

Regulations

(5) The Governor in Council may, on the recommendation of the Minister of the Environment, make regulations prescribing the form in which sustainable development strategies are to be prepared and the information required to be contained in them. 1995, c. 43, s. 5.

Appendix B *Financial Administration Act*

R.S., c. F-11
Extracts from Part X

CROWN CORPORATIONS
Financial Management

Books and systems

131. (1) Each parent Crown corporation shall cause

(a) books of account and records in relation thereto to be kept, and

(b) financial and management control and information systems and management practices to be maintained,

in respect of itself and each of its wholly-owned subsidiaries, if any.

Idem

(2) The books, records, systems and practices referred to in subsection (1) shall be kept and maintained in such manner as will provide reasonable assurance that

(a) the assets of the corporation and each subsidiary are safeguarded and controlled;

(b) the transactions of the corporation and each subsidiary are in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(c) the financial, human and physical resources of the corporation and each subsidiary are managed economically and efficiently and the operations of the corporation and each subsidiary are carried out effectively.

Internal audit

(3) Each parent Crown corporation shall cause internal audits to be conducted, in respect of itself and each of its wholly-owned subsidiaries, if any, to assess compliance with subsections (1) and (2), unless the Governor in Council is of the opinion that the benefits to be derived from those audits do not justify their cost.

Financial statements

(4) Each parent Crown corporation shall cause financial statements to be prepared annually, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with generally accepted accounting principles as supplemented or augmented by regulations made pursuant to subsection (6) if any.

Form of financial statements

(5) The financial statements of a parent Crown corporation and of a wholly-owned subsidiary shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation or subsidiary.

Regulations

(6) The Treasury Board may, for the purposes of subsection (4), make regulations respecting financial statements either generally or in respect of any specified parent Crown corporation or any parent Crown corporation of a specified class, but such regulations shall, in respect of the preparation of financial statements, only supplement or augment generally accepted accounting principles. 1991, c. 24, s. 41.

Auditor's Reports

Annual auditor's report

132. (1) Each parent Crown corporation shall cause an annual auditor's report to be prepared, in respect of itself and its wholly-owned subsidiaries, if any, in accordance with the regulations, on

(a) the financial statements referred to in section 131 and any revised financial statement referred to in subsection 133(3); and

(b) any quantitative information required to be audited pursuant to subsection (5).

Contents (2) A report under subsection (1) shall be addressed to the appropriate Minister and shall

(a) include separate statements, whether in the auditor's opinion,

(i) the financial statements are presented fairly in accordance with generally accepted accounting principles applied on a basis consistent with that of the preceding year,

(ii) the quantitative information is accurate in all material respects and, if applicable, was prepared on a basis consistent with that of the preceding year, and

(iii) the transactions of the corporation and of each subsidiary that have come to his notice in the course of the auditor's examination for the report were in accordance with this Part, the regulations, the charter and by-laws of the corporation or subsidiary and any directive given to the corporation; and

(b) call attention to any other matter falling within the scope of the auditor's examination for the report that, in his opinion, should be brought to the attention of Parliament.

Regulations (3) The Treasury Board may make regulations prescribing the form and manner in which the report referred to in subsection (1) is to be prepared.

Separate reports (4) Notwithstanding any other provision of this Part, the auditor of a parent Crown corporation may prepare separate annual auditor's reports on the statements referred to in paragraph (1)(a) and on the information referred to in paragraph (1)(b) if, in the auditor's opinion, separate reports would be more appropriate.

Audit of quantitative information (5) The Treasury Board may require that any quantitative information required to be included in a parent Crown corporation's annual report pursuant to subsection 150(3) be audited.

Other reports (6) The auditor of a parent Crown corporation shall prepare such other reports respecting the corporation or any wholly-owned subsidiary of the corporation as the Governor in Council may require.

Examination (7) An auditor shall make such examination as he considers necessary to enable him to prepare a report under subsection (1) or (6).

Reliance on internal audit (8) An auditor shall, to the extent he considers practicable, rely on any internal audit of the corporation being audited that is conducted pursuant to subsection 131(3). 1991, c. 24, s.42.

Errors and omissions **133.** (1) A director or officer of a Crown corporation shall forthwith notify the auditor and the audit committee of the corporation, if any, of any error or omission of which the director or officer becomes aware in a financial statement that the auditor or a former auditor has reported on or in a report prepared by the auditor or a former auditor pursuant to section 132.

Idem (2) Where an auditor or former auditor of a Crown corporation is notified or becomes aware of any error or omission in a financial statement that the auditor or former auditor has reported on or in a report prepared by the auditor or former auditor pursuant to section 132, he shall forthwith notify each director of the corporation of the error or omission if he is of the opinion that the error or omission is material.

Correction (3) Where an auditor or former auditor of a Crown corporation notifies the directors of an error or omission in a financial statement or report pursuant to subsection (2), the corporation shall prepare a revised financial statement or the auditor or former auditor shall issue a correction to the report, as the case may be, and a copy thereof shall be given to the appropriate Minister. 1984, c. 31, s. 11.

Auditors

Appointment of auditor **134.** (1) The auditor of a parent Crown corporation shall be appointed annually by the Governor in Council, after the appropriate Minister has consulted the board of directors of the corporation, and may be removed at any time by the Governor in Council, after the appropriate Minister has consulted the board.

Auditor General (2) On and after January 1, 1989, the Auditor General of Canada shall be appointed by the Governor in Council as the auditor, or a joint auditor, of each parent Crown corporation named in Part I of Schedule III, unless the Auditor General waives the requirement that he be so appointed.

Idem

(3) Subsections (1) and (2) do not apply in respect of any parent Crown corporation the auditor of which is specified by any other Act of Parliament to be the Auditor General of Canada, but the Auditor General is eligible to be appointed the auditor, or a joint auditor, of a parent Crown corporation pursuant to subsection (1) and section 135 does not apply to him.

Exception

(4) Notwithstanding subsection (1), where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the auditor of the subsidiary, and subsections (6) and sections 135 to 137 apply in respect of that auditor as though the references therein to a parent Crown corporation were references to the subsidiary.

Criteria for appointment

(5) The Governor in Council may make regulations prescribing the criteria to be applied in selecting an auditor for appointment pursuant to subsection (1) or (4).

Re-appointment

(6) An auditor of a parent Crown corporation is eligible for re-appointment on the expiration of his appointment.

Continuation in office

(7) Notwithstanding subsection (1), if an auditor of a parent Crown corporation is not appointed to take office on the expiration of the appointment of an incumbent auditor, the incumbent auditor continues in office until his successor is appointed. 1984, c.31, s.11.

Persons not eligible

135. (1) A person is disqualified from being appointed or re-appointed or continuing as an auditor of a parent Crown corporation pursuant to section 134 if that person is not independent of the corporation, any of its affiliates, or the directors or officers of the corporation or any of its affiliates.

Independence

(2) For the purpose of this section,

(a) independence is a question of fact; and

(b) a person is deemed not to be independent if that person or any of his business partners

- (i) is a business partner, director, officer or employee of the parent Crown corporation or any of its affiliates, or a business partner of any director, officer or employee of the corporation or any of its affiliates,
- (ii) beneficially owns or controls, directly or indirectly through a trustee, legal representative, agent or other intermediary, a material interest in the shares or debt of the parent Crown corporation or any of its affiliates, or
- (iii) has been a receiver, receiver-manager, liquidator or trustee in bankruptcy of the parent Crown corporation or any of its affiliates within two years of his proposed appointment as auditor of the corporation.

Resignation

(3) An auditor of a parent Crown corporation who becomes disqualified under this section shall resign forthwith after becoming aware of his disqualification. 1984, c.31, s.11.

Qualifications preserved

136. Nothing in sections 134 and 135 shall be construed as empowering the appointment, re-appointment or continuation in office as an auditor of a parent Crown corporation of any person who does not meet any qualifications for such appointment, re-appointment or continuation established by any other Act of Parliament. 1984, c. 31, s. 11.

Resignation

137. A resignation of an auditor of a parent Crown corporation becomes effective at the time the corporation receives a written resignation from the auditor or at the time specified in the resignation, whichever is later. 1984, c. 31, s. 11.

Special Examination

Special examination

138. (1) Each parent Crown corporation shall cause a special examination to be carried out in respect of itself and its wholly-owned subsidiaries, if any, to determine if the systems and practices referred to in paragraph 131(1)(b) were, in the period under examination, maintained in a manner that provided reasonable assurance that they met the requirements of paragraphs 131(2)(a) and (c).

Time for examination

(2) A special examination shall be carried out at least once every five years and at such additional times as the Governor in Council, the appropriate Minister or the board of directors of the corporation to be examined may require.

Plan

(3) Before an examiner commences a special examination, he shall survey the systems and practices of the corporation to be examined and submit a plan for the examination, including a statement of the criteria to be applied in the examination, to the audit committee of the corporation, or if there is no audit committee, to the board of directors of the corporation.

Resolution of disagreements

(4) Any disagreement between the examiner and the audit committee or board of directors of a corporation with respect to a plan referred to in subsection (3) may be resolved

(a) in the case of a parent Crown corporation, by the appropriate Minister; and

(b) in the case of a wholly-owned subsidiary, by the parent Crown corporation that wholly owns the subsidiary.

Reliance on internal audit

(5) An examiner shall, to the extent he considers practicable, rely on any internal audit of the corporation being examined conducted pursuant to subsection 131(3). 1984, c.31, s.11.

Report

139. (1) An examiner shall, on completion of the special examination, submit a report on his findings to the board of directors of the corporation examined.

Contents

(2) The report of an examiner under subsection (1) shall include

(a) a statement, whether in the examiner's opinion, with respect to the criteria established pursuant to subsection 138(3), there is reasonable assurance that there are no significant deficiencies in the systems and practices examined; and

(b) a statement of the extent to which the examiner relied on internal audits. 1984, c.31, s.11.

Special report of appropriate Minister

140. Where the examiner of a parent Crown corporation, or a wholly owned subsidiary of a parent Crown corporation, named in Part I of Schedule III is of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of the appropriate Minister, he shall, after consultation with the board of directors of the corporation, or with the board of the subsidiary and corporation, as the case may be, report that information to the Minister and furnish the board or boards with a copy of the report. 1984, c.31, s.11.

Special report to Parliament

141. Where the examiner of a parent Crown corporation, or a wholly-owned subsidiary of a parent Crown corporation, named in Part I of Schedule III of the opinion that his report under subsection 139(1) contains information that should be brought to the attention of Parliament, he shall, after consultation with the appropriate Minister and the board of directors of the corporation, or with the boards of the subsidiary and corporation, as the case may be, prepare a report thereon for inclusion in the next annual report of the corporation and furnish the board or boards, the appropriate Minister and the Auditor General of Canada with copies of the report. 1984, c.31, s.11.

Examiner

142. (1) Subject to subsections (2) and (3), a special examination referred to in section 138 shall be carried out by the auditor of a parent Crown corporation.

Idem

(2) Where, in the opinion of the Governor in Council, a person other than the auditor of a parent Crown corporation should carry out a special examination, the Governor in Council may, after the appropriate Minister has consulted the board of directors of the corporation, appoint an auditor who is qualified for the purpose to carry out the examination in lieu of the auditor of the corporation and may, after the appropriate Minister has consulted the board, remove that qualified auditor at any time.

Exception

(3) Where a special examination is to be carried out in respect of a wholly-owned subsidiary separately, the board of directors of the parent Crown corporation that wholly owns the subsidiary shall, after consultation with the board of directors of the subsidiary, appoint the qualified auditor who is to carry out the special examination.

Applicable provisions

(4) Subject to subsection (5), sections 135 and 137 apply in respect of an examiner as though the references therein to an auditor were references to an examiner.

Auditor General eligible

(5) The Auditor General of Canada is eligible to be appointed an examiner and section 135 does not apply to the Auditor General of Canada in respect of such an appointment. 1984, c. 31, s. 11.

Consultation with Auditor General

Consultation with Auditor General

143. The auditor or examiner of a Crown corporation may at any time consult the Auditor General of Canada on any matter relating to his audit or special examination and shall consult the Auditor General with respect to any matter that, in the opinion of the auditor or examiner, should be brought to the attention of Parliament pursuant to paragraph 132(2)(b) or section 141. 1984, c. 31, s. 11.

Right to Information

Right to Information

144. (1) On the demand of the auditor or examiner of a Crown corporation, the present or former directors, officers, employees or agents of the corporation shall furnish such

(a) information and explanations, and

(b) access to records, documents, books, accounts and vouchers of the corporation or any of its subsidiaries

as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the directors, officers, employees or agents are reasonably able to furnish.

Idem

(2) On the demand of the auditor or examiner of a Crown corporation, the directors of the corporation shall

(a) obtain from the present or former directors, officers, employees or agents of any subsidiary of the corporation such information and explanations as the auditor or examiner considers necessary to enable him to prepare any report as required by this Division and that the present or former directors, officers, employees or agents are reasonably able to furnish; and

(b) furnish the auditor or examiner with the information and explanations so obtained.

Reliance on reports

(3) An auditor or examiner of a Crown corporation may reasonably rely on any report of any other auditor or examiner. 1984, c. 31, s. 11.

Policy

Restriction

145. Nothing in this Part or the regulations shall be construed as authorizing the auditor or examiner of a Crown corporation to express any opinion on the merits of matters of policy, including the merits of

(a) the objects or purposes for which the corporation is incorporated, or the restrictions on the businesses or activities that it may carry on, as set out in its charter;

(b) the objectives of the corporation; and

(c) any business or policy decision of the corporation or of the Government of Canada. 1984, c. 31, s. 11.

Qualified Privilege

Qualified privilege

146. Any oral or written statement or report made under this Part or the regulations by the auditor or a former auditor, or the examiner or a former examiner, of a parent Crown corporation or a wholly-owned subsidiary has qualified privilege. 1991, c. 24, s. 43.

Costs

Cost of audit and examination

147. (1) The amounts paid to an auditor or examiner of a Crown corporation for preparing any report under section 132, 139, 140 or 141 shall be reported to the President of the Treasury Board.

Idem

(2) Where the Auditor General of Canada is the auditor or examiner of a Crown corporation, the costs incurred by him in preparing any report under section 132, 139, 140 or 141 shall be disclosed in the next annual report of the Auditor General and be paid out of the moneys appropriated for his office. 1984, c. 31, s. 11.

Audit Committee

Audit committee

148. (1) Each parent Crown corporation that has four or more directors shall establish an audit committee composed of not less than three directors of the corporation, the majority of whom are not officers or employees of the corporation or any of its affiliates.

Idem

(2) In the case of a parent Crown corporation that has less than four directors, the board of directors of the corporation constitutes the audit committee of the corporation and shall perform the duties and functions assigned to an audit committee by any provision of this Part and the provision shall be construed accordingly.

Duties

(3) The audit committee of a parent Crown corporation shall

(a) review, and advise the board of directors with respect to, the financial statements that are to be included in the annual report of the corporation;

(b) oversee any internal audit of the corporation that is conducted pursuant to subsection 131(3);

(c) review, and advise the board of directors with respect to, the annual auditor's report of the corporation referred to in subsection 132(1);

(d) in the case of a corporation undergoing a special examination, review, and advise the board of directors with respect to, the plan and reports referred to in sections 138 to 141; and

(e) perform such other functions as are assigned to it by the board of directors or the charter or by-laws of the corporation.

Auditor's or examiner's attendance

(4) The auditor and any examiner of a parent Crown corporation are entitled to receive notice of every meeting of the audit committee and, at the expense of the corporation, to attend and be heard at each meeting; and, if so requested by a member of the audit committee, the auditor or examiner shall attend any or every meeting of the committee held during his term of office.

Calling meeting

(5) The auditor or examiner of a parent Crown corporation or a member of the audit committee may call a meeting of the committee.

Wholly-owned subsidiary

(6) Where the report referred to in subsection 132(1) is to be prepared in respect of a wholly-owned subsidiary separately, subsections (1) to (5) apply, with such modifications as the circumstances require, in respect of the subsidiary as though

(a) the references in subsections (1) to (5) to a parent Crown corporation were references to the subsidiary; and

(b) the reference in paragraph (3)(a) to the annual report of the corporation were a reference to the annual report of the parent Crown corporation that wholly owns the subsidiary. 1984, c. 31, s. 11.

Reports

Accounts, etc. to Treasury Board or appropriate Minister

149. (1) A parent Crown corporation shall provide the Treasury Board or the appropriate Minister with such accounts, budgets, returns, statements, documents, records, books, reports or other information as the Board or appropriate Minister may require.

Reports on material developments

(2) The chief executive officer of a parent Crown corporation shall, as soon as reasonably practicable, notify the appropriate Minister, the President of the Treasury Board and any director of the corporation not already aware thereof of any financial or other developments that, in the chief executive officer's opinion, are likely to have a material effect on the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives or on the corporation's requirements for funding.

Reports on wholly-owned subsidiaries

(3) Each parent Crown corporation shall forthwith notify the appropriate Minister and the President of the Treasury Board of the name of any corporation that becomes or ceases to be a wholly-owned subsidiary of the corporation. 1984, c. 31, s. 11.

Annual report

150. (1) Each parent Crown corporation shall, as soon as possible, but in any case within three months, after the termination of each financial year submit an annual report on the operations of the corporation in that year concurrently to the appropriate Minister and the President of the Treasury Board, and the appropriate Minister shall cause a copy of the report to be laid before each House of Parliament on any of the first fifteen days on which that House is sitting after he receives it.

Reference to committee

(2) An annual report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to the businesses and activities of the corporation submitting the report.

Form and contents

(3) The annual report of a parent Crown corporation shall include

(a) the financial statements of the corporation referred to in section 131,

(b) the annual auditor's report referred to in subsection *132(1)*,

(c) a statement on the extent to which the corporation has met its objectives for the financial year,

(d) such quantitative information respecting the performance of the corporation, including its wholly-owned subsidiaries, if any, relative to the corporation's objectives as the Treasury Board may require to be included in the annual report, and

(e) such other information as is required by this or any other Act of Parliament, or by the appropriate Minister, the President of the Treasury Board or the Minister of Finance, to be included in the annual report,

and shall be prepared in a form that clearly sets out information according to the major businesses or activities of the corporation and its wholly-owned subsidiaries, if any.

Idem

(4) In addition to any other requirements under this Act or any other Act of Parliament, the Treasury Board may, by regulation, prescribe the information to be included in annual reports and the form in which such information is to be prepared. 1991, c. 24, s. 49.

Annual consolidated report

151. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause a copy of an annual consolidated report on the businesses and activities of all parent Crown corporations for their financial years ending on or before the previous July 31 to be laid before each House of Parliament.

Reference to committee

(2) An annual consolidated report laid before Parliament pursuant to subsection (1) stands permanently referred to such committee of Parliament as may be designated or established to review matters relating to Crown corporations.

Contents

(3) The annual consolidated report referred to in subsection (1) shall include

(a) a list naming, as of a specified date, all Crown corporations and all corporations of which any shares are held by, on behalf of or in trust for the Crown or any Crown corporation;

(b) employment and financial data, including aggregate borrowings of parent Crown corporations; and

(c) such other information as the President of the Treasury Board may determine. 1984, c.31, s. 11.

Annual report

152. (1) The President of the Treasury Board shall, not later than December 31 of each year, cause to be laid before each House of Parliament a copy of a report indicating the summaries and annual reports that under this Part were to be laid before that House by July 31 in that year, the time at, before or within which they were to be laid and the time they were laid before that House.

Attest

(2) The accuracy of the information contained in the report referred to in subsection (1) shall be attested by the Auditor General of Canada in the Auditor General's report to the House of Commons. 1991, c. 24, s. 44.

Appendix C Reports of the Standing Committee on Public Accounts to the House of Commons, 2003–04

The following reports have been tabled since our November 2003 Report was published. They are available on the Web site of Canada's Parliament (www.parl.gc.ca).

37th Parliament, 2nd Session

Report 24—Chapter 10 (Department of Justice—Costs of Implementing the Canadian Firearms Program) of the December 2002 Report of the Auditor General of Canada (presented in the House, 30 October 2003)

Report 25—Chapter 5 (Citizenship and Immigration Canada—Control and Enforcement) of the April 2003 Report of the Auditor General of Canada (presented in the House, 6 November 2003)

Report 26—Chapter 4 (Correctional Service Canada—Reintegration of Women Offenders) of the April 2003 Report of the Auditor General of Canada (presented in the House, 6 November 2003)

37th Parliament, 3rd Session

Report 1—Whistle-blowing legislation (presented in the House, 25 February 2004)

Report 2—Whistle-blowing legislation (presented in the House, 12 March 2004)

Report 3—Peer Review Report on the value for money practices of the Office of the Auditor General of Canada (presented in the House, 1 April 2004)

Report 4—Report of the Auditor General of Canada on the Office of the Privacy Commissioner of Canada (presented in the House, 19 April 2004)

Report 5—Legal fees of public servants who have been called to testify (presented in the House, 21 April 2004)

Appendix D Report on the audit of the President of the Treasury Board's report to Parliament

Tablings in parliament for parent crown corporations: annual reports and summaries of corporate plans and budgets

The *Financial Administration Act* requires the President of the Treasury Board to table in each House of Parliament a report on the timing of tabling, by appropriate ministers, of annual reports and summaries of corporate plans and budgets of Crown corporations subject to the reporting provisions of Part X of the Act. The Act also requires the Auditor General to audit the accuracy of this report and to present the results in her annual report to the House of Commons.

The report on tablings is the responsibility of the President of the Treasury Board and is included in his *2004 Annual Report to Parliament–Crown Corporations and Other Corporate Interests of Canada,* which must be tabled no later than 31 December. (The 2004 report had not been tabled at time that our Report was published.) The report on tablings allows Parliament to hold the appropriate ministers (and, ultimately, the Crown corporations) accountable for providing, within the relevant statutory deadlines, the information required under the Act. Accordingly, the report must indicate "the time at, before or within which" the annual reports and the summaries of corporate plans, capital budgets, and operating budgets (and amendments to them) were required to be tabled in each House and the date they were actually tabled.

Auditor's report

To the House of Commons

As required by subsection 152(2) of the *Financial Administration Act*, I have audited, for the year ended 31 July 2004, the information presented in the report *Tabling of Crown Corporations Reports in Parliament* included in the *2004 Annual Report to Parliament–Crown Corporations and Other Corporate Interests of Canada*. The report is the responsibility of the President of the Treasury Board. My responsibility is to express an opinion on this information based on my audit.

I conducted my audit in accordance with the standards for assurance engagements established by the Canadian Institute of Chartered Accountants. Those standards require that I plan and perform an audit to obtain reasonable assurance as to whether the information disclosed in the report is free of significant misstatement. My audit included examining, on a test basis, evidence supporting the dates and other disclosures provided in the report.

In my opinion, the information presented in the report *Tabling of Crown Corporations Reports in Parliament* is accurate in all significant respects and in accordance with the section, The Deadlines for Tabling in Parliament.

The following paragraph highlights certain information that I believe may be of interest to parliamentarians and that is not specifically highlighted or disclosed in the report *Tabling of Crown Corporations Reports in Parliament* in its current format. Compared with last year, the timeliness of corporate reporting has improved.

Our analysis of the information presented in this year's report identifies 55 documents that were tabled late. This is a decrease of 17 over last year. However, the report does not disclose that in 10 instances (18 last year), corporate plans were approved by the Governor in Council after the beginning of the period covered by the plans. Furthermore, in 3 of those instances (14 last year), the plans were approved more than two months after the beginning of the period covered by the plan.

Richard Flageole, FCA
Assistant Auditor General
for the Auditor General of Canada

Ottawa, Canada
18 October 2004

Appendix E Costs of Crown corporation audits conducted by the Office of the Auditor General of Canada

The Office is required under section 147 of the *Financial Administration Act* to disclose the cost of preparing audit reports on all Crown corporations (Exhibit E.1), other than those exempted under section 85 of the Act. An audit report provides an opinion on a corporation's financial statements and on its compliance with specified authorities. It may also report on any other matter deemed significant.

The Office is required by section 68 of the *Broadcasting Act* to report the cost of any audit report on the Canadian Broadcasting Corporation. For the fiscal year ended 31 March 2004, the full cost of the annual audit report was $698,535.

In 2003-2004 the Office completed the special examination of seven Crown corporations.

A special examination determines whether a corporation's financial and management control and information systems and its management practices provide reasonable assurance that

- assets have been safeguarded and controlled;
- financial, human, and physical resources have been managed economically and efficiently; and
- operations have been carried out effectively.

The costs of the special examinations were

Cape Breton Development Corporation	$ 434,990
Defence Construction Limited	181,470
Federal Bridges Corporation Limited	312,578
Pacific Pilotage Authority Canada	126,973
VIA Rail Canada Inc.	1,177,654
Canada Development Investment Corporation (joint auditor)	61,648
Canada Mortgage and Housing Corporation (joint auditor)	829,487

Exhibit E.1 Cost of preparing annual audit reports for fiscal years ending on or before 31 March 2004

Crown Corporation	Fiscal year ended	Cost
Atlantic Pilotage Authority	31.12.03	$70,230
Atomic Energy of Canada Limited (joint auditor)	31.03.04	279,457
Blue Water Bridge Authority	31.08.04	48,200
Business Development Bank of Canada (joint auditor)	31.03.04	319,887
Canada Deposit Insurance Corporation	31.03.04	93,921
Canada Development Investment Corporation (joint auditor)	31.12.03	65,860
Canada Lands Company Limited (joint auditor)	31.03.04	310,485
Canada Mortgage and Housing Corporation (joint auditor)	31.12.03	287,889
Canadian Commercial Corporation	31.03.04	110,736
Canadian Dairy Commission	31.07.03	131,228
Canadian Museum of Civilization	31.03.04	99,650
Canadian Tourism Commission	31.12.03	280,124
Canadian Museum of Nature	31.03.04	106,662
Cape Breton Development Corporation	31.03.04	106,461
Cape Breton Growth Fund	31.03.04	33,026
Canadian Air Transportation Security Authority	31.03.04	308,520
Defence Construction (1951) Limited	31.03.04	74,597
Enterprise Cape Breton Corporation	31.03.04	97,226
Export Development Canada	31.12.03	600,438
Farm Credit Canada	31.03.04	507,919
Federal Bridge Corporation Ltd.	31.03.04	34,435
Freshwater Fish Marketing Corporation	30.04.03	118,119
Great Lakes Pilotage Authority	31.12.03	115,694
Laurentian Pilotage Authority	31.12.03	76,825
Jacques Cartier and Champlain Bridges Incorporated	31.03.04	86,491
Marine Atlantic Inc.	31.12.03	251,369
National Capital Commission	31.03.04	188,824
National Gallery of Canada	31.03.04	99,986
National Museum of Science and Technology	31.03.04	65,162
Old Port of Montreal Corporation Inc.	31.03.04	202,822
Pacific Pilotage Authority	31.12.03	45,807
Queens Quay West Land Corporation	31.03.04	43,275
Royal Canadian Mint	31.12.03	373,858
Ridley Terminals Inc.	31.12.03	71,101
Seaway International Bridge Corporation Ltd.	31.12.03	53,888
Standards Council of Canada	31.03.04	52,648
VIA Rail Canada Inc. (joint auditor)	31.12.03	284,722

Report of the Auditor General of Canada to the House of Commons—November 2004

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